Bloomberg Businessweek
May 8 — May 14, 2017 | bloomberg.com

Bloomberg Businessweek
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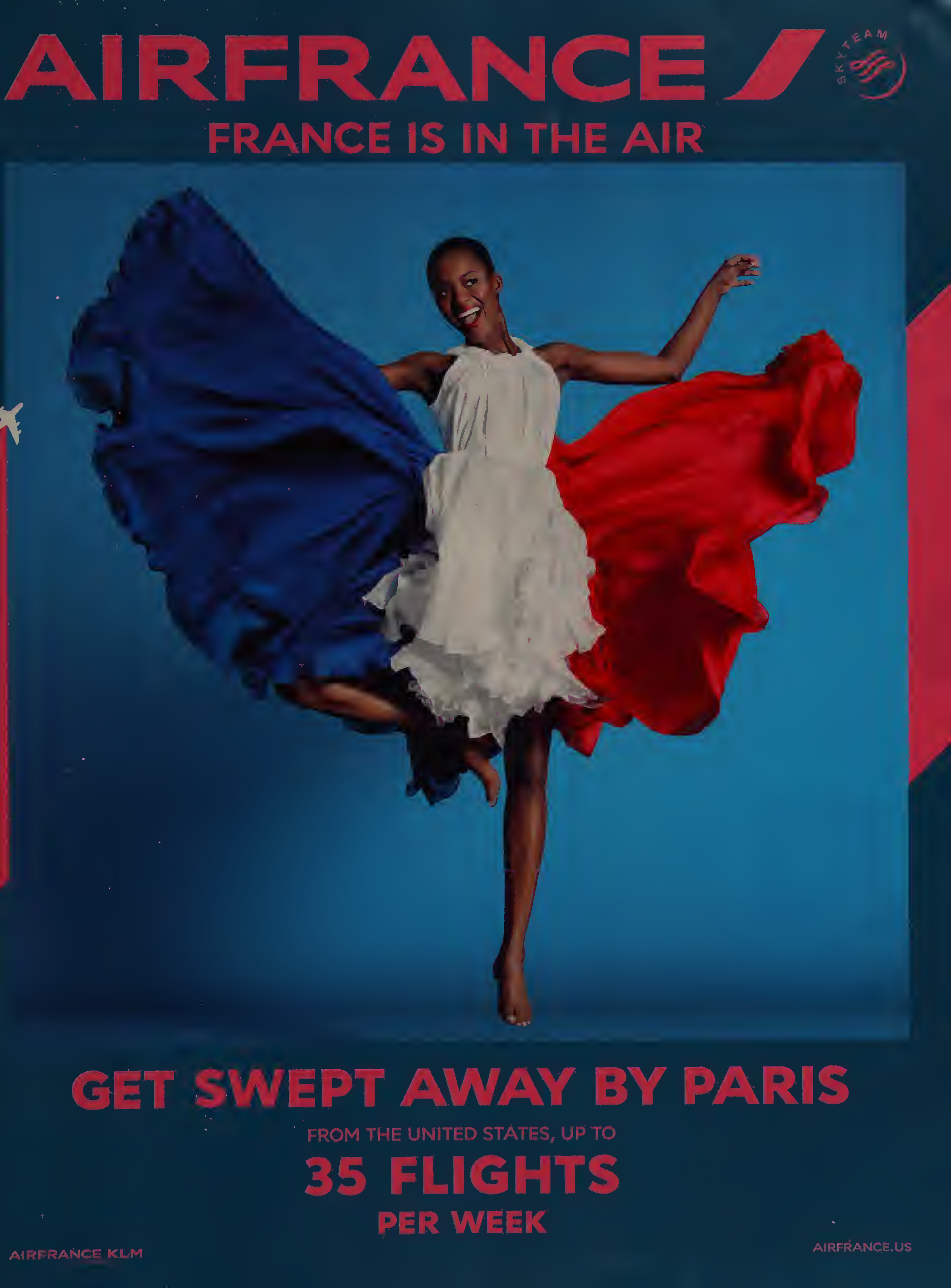
❶ "Our story is about Wal-Mart. They have a new strategy to compete with Amazon."

"Best of luck to them. Do you know that last week I got 100 heavy-duty scrubbing pads, 2 gallons of bleach, and a fishnet bodysuit delivered to my door the next day with a touch of a button using Amazon Prime? Can Wal-Mart do that?"

"Why, exactly, did you need those items so urgently?"

"I've already said too much."

COVER: JOHN KEATLEY/REDUX; ILLUSTRATION BY SALLY THURER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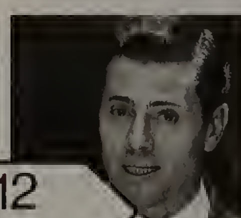

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Bloomberg Businessweek

In Ads We Trust

By Ashlee Vance

Google and Facebook have idealistic visions for our future. But first they'd like you to click

In 2011 a young computer scientist named Jeff Hammerbacher said something profound while explaining why he'd decided to leave Facebook–and the promise of a small fortune–to start a company. "The best minds of my generation are thinking about how to make people click ads," he said. "That sucks."

Hammerbacher was getting at the idea that so many of the world's best and brightest people flocking to Silicon Valley for jobs at companies such as Facebook Inc. and Google Inc. might be an unhealthy use of human capital. Sure, these companies offered plenty of interesting work, but much of it revolved around the core business of advertising. Very smart people were pouring their energy into an unromantic goal: keeping the rest of us on their websites so we might click on an ad for an irritable bowel syndrome cure.

Hammerbacher's flippant remark has lived on because it captures a crucial sentiment, one that's even more important today than in 2011. Google and Facebook are unlike any other two companies in history. They're technology-and-advertising hybrids–strange amalgams with incredible power. They're building the tools we use to communicate, to do business, to form and maintain relationships, to learn, to travel to and fro, and to relax. And they're doing all of this while being wholly dependent on ad dollars for their survival. Never have advertising companies had such an all-encompassing influence on our life. And next year it will be even greater.

Google and Facebook each started out as a useful, simple idea. Google made a small search box that allowed people to find things on the web faster than any other small search box before it. Facebook morphed from a way to find attractive incoming college freshmen to a handy public scrapbooking site.

These beginnings seem almost silly now. Today, Google funds self-driving cars, television shows, robots, ubiquitous smartphone software, and even cures for death. The company changed its name to Alphabet–inventions from A to Z–to capture the breadth of its portfolio. Its greatest achievement may be the creation of artificial intelligence software that has a decent chance of altering the future of the human species, for way, way better or for way, way worse. Facebook also funds ample AI research. Its tools sit at the heart of how millions–if not billions–of people get news about the world. Its algorithms have proved effective enough to nudge history in various directions. Up next, Facebook will pump billions of dollars into virtual-reality technology, hoping to become the dominant force in shaping a new universe for humankind.

Mark Zuckerberg, Facebook's co-founder and chief executive officer, has ambitions beyond all of this. He recently wrote a letter that positioned Facebook–and himself–as stewards of a global community. The letter is almost 6,000 words long and full of jargon, but in spots, Zuckerberg makes his point clearly enough. "Our goal is to strengthen existing communities by helping us come together online as well as offline, as well as enabling us to form completely new communities, transcending physical location," he writes. Later, he adds: "The path forward is to recognize that a global community needs social infrastructure to keep us safe from threats around the world and that our community is uniquely positioned to prevent disasters, help during crises, and rebuild afterward. Keeping the global community safe is an important part of our mission and an important part of how we'll measure our progress going forward." All hail Zuckerberg the Benevolent.

Last year, Google had sales of $90.2 billion, and Facebook took in $27.6 billion–in both cases the majority

of that revenue came from advertising. Together, the companies account for about 65 percent of the money spent on digital ads and 90 percent of the growth in the market. More and more ad money is expected to shift from TV and print media to online formats in the coming years, which will mean more and more dollars for Google and Facebook, solidifying their duopoly.

High-profit, dominant businesses have historically been fruitful for the technology industry and the economy overall. AT&T Inc.'s deep pockets gave us Bell Labs, which invented the transistor and the laser. Xerox Corp.'s copiers gave birth to Xerox PARC, which invented much of today's computing infrastructure. Following in these footsteps were the laboratories of International Business Machines, Hewlett-Packard, and Sun Microsystems. The underlying drive of these companies was to produce ever-better stuff that other businesses and people would buy. Google and Facebook resemble these innovation temples, but their motivations and convictions are much harder to pinpoint.

The companies purport to care. Google's slogan is "Don't be evil," and Facebook wants to envelop all of humanity in a binary safety net. Both companies, though, are ultimately slaves to a type of algorithmic worldview. Their cultures are based on exploiting inefficiencies and manipulating human interaction. "I don't think there has been any analogue where computers have been able to do high-speed data science against humans," says George John, the former CEO of Rocket Fuel Inc., an ad tech company. "It's sort of unfair. You have these planet-scale databases of what a billion other people have done. The computers are amoral but can be so effective."

Ads may or may not be inherently evil. They're certainly a major cultural force. They promote consumption and progress and convince us that we'll feel better after we buy something. In the past our ads were delivered via newspaper, radio, and TV. The trade-off was your attention for free entertainment. Today, ads follow people around all the time on computer and smartphone screens, and they're not the dumb variety of yore. They're precision-guided pellets of propaganda built for you based on everything you do.

"Google, Facebook, and the other data giants have much greater power than any previous attention merchant, and I suspect that their true business isn't to sell attention," says Yuval Noah Harari, an historian and author of *Homo Deus: A Brief History of Tomorrow*. "Rather, by capturing our attention they manage to accumulate immense amounts of data about us, which is worth more than any advertisement fees. Potentially, this data might enable them to hack humans, to create superior artificial intelligence, and to take control of our lives."

Google and Facebook both pursue lofty ideals and champion hopeful aspirations. But there remains a fracture between their inventive side and the motivations of their core business. Google may want to cure death, and Facebook may want to bring an epic virtual reality to life. It's just that along the way, the companies would really like to make sure that you're online as much as possible and that their algorithms know as much as possible about you, so they can sell you more stuff. This is the first time engineers–paid for by advertising–have risen to such a crucial role in our future. "Nerds never had such power before," Harari says. "On the whole, I think humanity is much better off in the hands of nerds than in the hands of the Genghis Khans and the Napoleons. Yet there are dangers inherent in nerd power, too."

As Harari says, Zuckerberg is likely right to call for some type of global community, and Facebook is arguably in the best position to build one. "All our major problems are global in nature: global warming, global inequality, and the rise of disruptive technologies such as artificial intelligence and bioengineering," he says. "My impression is that if humankind fails to create a truly global community in the 21st century, we are heading toward an unprecedented disaster."

"You cannot bring humankind together if you are busy selling advertisements"

The question is whether Zuckerberg wants people leaving their computers to gather together in the world or whether that's just more lip service to distract us. "I think it is good that Facebook is interested in helping to create a global community rather than in just making money," Harari says. "But if Facebook is sincere about it, it will probably have to change its business model. You cannot bring humankind together if you are busy selling advertisements."

Many early engineers from Google, Facebook, and similar companies have consciously moved away from ad brokering into new fields. Hammerbacher has dedicated the past few years to finding a cure for cancer. DJ Patil, who coined the term "data scientist" with Hammerbacher, ditched Silicon Valley to become the U.S. chief data scientist for the previous administration. "President Obama tasked me with using data to focus on precision health care and using data to improve health care for the masses," Patil says. "I see things now more as people running away as fast as they can from trying to get people to click on ads to using these superpowers for something different." Ⓑ

To read Mohamed El-Erian on the shifting Federal Reserve and Leonid Bershidsky on Netflix and online piracy, go to
Bloombergview.com

May Should Go Easy On Brexit Promises

Voters need a fuller account of her brand of centrist Toryism

British Prime Minister Theresa May recently surprised the country–and most of her ministers–by calling an election for early June. Up against self-imposed deadlines, and anxious to increase her majority in Parliament, she's scrambling to devise a policy platform.

With Brexit looming, this isn't a normal election, and the usual litany of detailed proposals won't serve. For the purposes of this manifesto and this election, less is more.

May needs to set out her basic approach to the Brexit talks, but she can't afford to get too specific because she has a weak hand and will have to give way on many issues. What she can do, though, is set out the principles that will guide her team: Britain should seek the closest possible relationship with the European Union while recovering its powers as a sovereign nation–in particular, the right to control its borders and make its own laws.

Controlling the borders, May should note, doesn't mean an unduly restrictive policy on immigration. EU workers already in the country should be assured they can stay regardless of the EU's position on British workers in Europe. If the U.K. intends to be a beacon of outward-looking liberalism after its divorce, it can start with that. May should also say that Britain can agree to a temporary transitional agreement in which most of its obligations as an EU member would remain. This could be important if exit negotiations aren't completed in two years, which seems likely.

This election, though, is not only about Europe. Again, the Tory platform should avoid making promises the government would soon regret. May's manifesto should unmake some of the unwise promises of her predecessor, David Cameron, such as the "triple lock" that guaranteed increases in the state pension –a policy that's fiscally unsound and increasingly unfair to poor people who don't happen to be pensioners. Without offering hostages to fortune, May should instead give a fuller account of her brand of centrist Toryism. If she's smart, she'll quash the suspicion that she favors an interventionist industrial policy. But she should underline her determination to make the economy work better for the country outside London and for people with jobs who nonetheless struggle to make ends meet.

Policies that push public investment to the regions, empower growth-oriented local governments, improve public education, and lift the tax burden from the low-paid would serve this purpose. British election manifestoes almost always promise too much, and disappointment follows with dreary regularity. May can break this cycle by making a forthright defense of the values and priorities of the government she intends to lead. If she does, and wins, she will have earned her mandate to govern.

Leaky Pipes Are a Fixable Climate Threat

Natural gas seeping through lawns and sidewalks traps heat with dangerous efficiency

An invisible, underappreciated source of greenhouse gases is right in America's front yards: leaking pipes that carry gas into people's homes. The good news is scientists have devised a clever way to find these leaks by attaching methane detectors to car bumpers–they've used Google Street View photography cars–and driving along city streets. It's a strategy that natural gas utilities should use to monitor their networks and seal the biggest leaks.

Utility companies and their state regulators' primary concern is leaks that threaten to explode. Even rather large leaks are often considered "nonhazardous" if they're venting into the air through someone's front lawn or cracks in the sidewalk.

But leaked natural gas–largely methane–is a hazardous greenhouse gas. Although it's not as ubiquitous as carbon dioxide and remains in the air for only about a decade (compared with more than a century for CO_2), methane is 80 times better at trapping heat. So even though leaks from city networks make up a small fraction of all methane leaks in the U.S., they can do significant climate damage.

Putting those methane detectors on car bumpers is a way to quickly assess a city's leaks and steer utilities toward the biggest offenders. In the places scientists have examined so far, a small number of large leaks account for an outsize share of the problem. By plugging just 20 percent of the leaks, utilities can cut their methane emissions in half.

State governments should require utilities to monitor leaks, prioritize them, and get to work plugging them. This is a case in which scientists have been able to deploy new technology both to identify the scope of a climate problem and to create a path toward solving it. Natural gas utilities–and their state regulators–should take advantage of the breakthrough. Ⓑ

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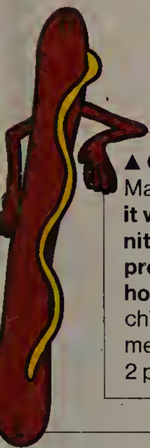
Movers

By Kyle Stock

Ups

▲ The value of a bitcoin surged to a record **$1,481** on May 2. **The juice came from Japan, which recently deemed the digital currency a legal form of payment.**

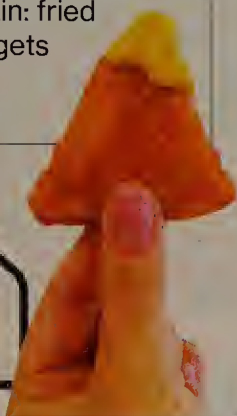


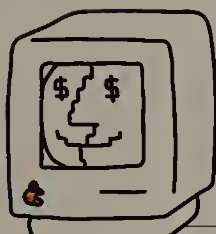
▲ Oscar Mayer said **it will no longer add nitrates and artificial preservatives to its hot dogs.** Sales of chilled processed meat slipped 2 percent last year.

▲ IAC/InterActiveCorp agreed to buy Angie's List for $500 million, a 44 percent premium to the contractor-search service's recent value. **Angie's List will be combined with IAC's HomeAdvisor unit.**

▲ South Korean presidential candidates with cards reading "Let's vote" before an April 28 TV debate in Seoul. The country, which has been without a president since Park Geun-hye was ousted in March in a corruption scandal, heads to the polls on May 9.

▲ Yum! Brands beat profit estimates in the first quarter, as its **Taco Bell unit increased same-store sales by 8 percent.** A new offering from the Mexican chain: fried chicken nuggets shaped like tortilla chips.

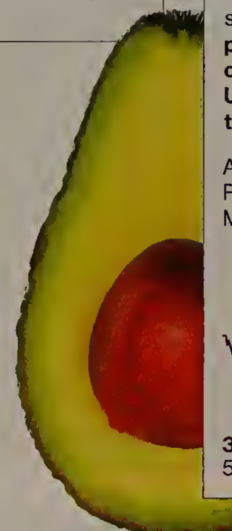




▲ **Ditching department stores is paying off for Coach.** In the recent quarter, its profit margin rose to 71 percent from 69 percent the year before. Handbags priced at $400 and up accounted for an increasing share of sales.

$257b

▲ Apple's cash on hand in April, which exceeds the stock market value of Wal-Mart Stores. **More than 90 percent of it is stashed outside the U.S.**



▲ Avocado prices hit a 19-year high, as Mexico harvests a thin crop. With Americans hungry for so-called healthy fats, **per capita avocado consumption in the U.S. has doubled in the past decade.**

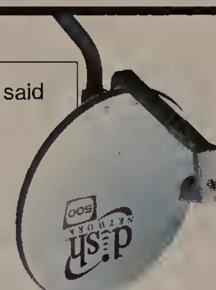
Avocados
Price per 10kg box, Mexican pesos

"A great quarter, but what comes next?"

Rob Sanderson, an MKM Partners analyst, reacting to **Facebook's first-quarter earnings—sales jumped 49 percent from the previous year**—and questioning how much the company's plan to stop increasing the frequency of ads shown in users' news feeds later this year will affect growth.

Downs

▼ Dish Network said it lost **143k** subscribers in the first three months of the year, as cord cutting intensified. **In the past 12 months, 2.5 percent of its customers have tuned out.**



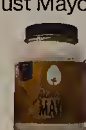
▼ **The Eagles sued Hotel California,** an 11-room lodging in Todos Santos, Mexico, for trademark infringement. The band said the hotel "actively encourages" an association with its most famous song. It's seeking profits and damages. The hotel hasn't yet responded.

▼ Family-run Molina Healthcare replaced its CEO and CFO, who are brothers. **Shares of the insurer, a specialist in Medicaid, have fallen as lawmakers have again pledged to repeal and replace the Affordable Care Act.**

▼ **Etsy replaced its CEO and vowed to cut 8 percent of its workforce** after posting a $421,000 loss in the first quarter, from a profit of $1.2 million a year earlier.

▼ After four consecutive months of swooning sales, **U.S. auto companies will idle factories three or four times this summer,** analysts say. At Ford, 7.1 percent fewer vehicles left dealerships this April than in April 2016.

▼ Vegan food company **Hampton Creek dismissed three senior executives** as it struggles to rein in costs and raise more venture capital. Last year it asked contractors to buy loads of its Just Mayo product, which simulated a spike in demand.



▼ JPMorgan Chase said **it would move up to 1,000 London bankers to Dublin, Frankfurt, and Luxembourg** in preparation for Brexit. The company is preparing for a scenario in which the regions won't have a passport deal.

Why Mexico's Autoworkers Aren't Prospering

▶ Wages are stagnant despite new plant openings, and unions are mainly to blame

▶ "Protection contracts are at the heart of the pressure on factory wages"

At a ceremony at Mexico's Los Pinos presidential residence in July 2014, **BMW** Chief Executive Officer Harald Krüger pledged to spend $1 billion to build a factory in the northern state of San Luis Potosí that will employ 1,500 workers. To mark the occasion, he presented President Enrique Peña Nieto with a model of a silver BMW race car.

The German automaker had unwrapped its own gift two days earlier, a labor contract signed by a representative from the state chapter of the Confederación de Trabajadores de México (CTM), the country's largest union confederation, and notarized by a Labor Ministry official. The document, which Bloomberg reviewed, sets a starting wage of about $1.10 per hour and a top wage of $2.53 for assembly-line workers. The starting rate is only a bit more than half the $2.04 an hour that is the average at Mexican auto plants, says Alex Covarrubias, a lecturer at the University of Sonora in Hermosillo.

The paperwork was filed two years before BMW broke ground on the new plant, which will turn out $45,000 3 Series sedans. When workers begin to stream into the factory sometime next year, there's a good chance most won't know they belong to a union.

So-called protection contracts—agreements negotiated between a company and a union that doesn't legitimately represent workers—are illegal in the U.S. and Germany. But Lance Compa, a senior lecturer at Cornell's School of Industrial and Labor Relations, says they're standard operating procedure in Mexico, where deals are cut factory by factory rather than collectively across a company or industry. Experts say this is a primary reason that wages in the auto sector have stagnated in recent years, despite a fresh wave of investments by foreign

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Krüger (left) and Peña Nieto celebrate BMW's new 3 Series plant

carmakers, most recently by German and Japanese manufacturers. Mexico's union bosses and politicians are more interested in keeping corporations happy than in raising the living standards of workers, Covarrubias argues. "Protection contracts are a way to keep wages artificially low," he says.

Since 2010, automakers have announced $24 billion in investments through 2019, while parts makers have committed another $3 billion, according to the Center for Automotive Research in Ann Arbor, Mich. Companies often cite the trade agreements Mexico has signed with 45 countries as a key reason they want to locate their plants there. Auto executives will rarely say they chose Mexico because its workers are among the cheapest in the world.

Mexican assembly-line workers earn about one-tenth of what their U.S. counterparts make. Adjusted for productivity, base wages for workers in plants that make transportation equipment rose 20 percent in Mexico between 2006 and 2016, according to calculations by Boston Consulting Group Inc.; in China, they climbed 157 percent over the same period.

Alejandra makes about $1.45 an hour working at a factory in Guanajuato state owned by **Hirschmann Automotive GmbH**, an Austrian parts maker. The machine operator, who asked that her last name not be used for fear of retaliation, says she has no idea if she and her co-workers are represented by a union. A public records search revealed that a CTM affiliate registered a contract in July 2015, almost two years before the factory was formally inaugurated. Perhaps Alejandra is in the dark because the union collects dues from Hirschmann, rather than employees—a common practice in Mexico.

Alejandra's wage is about double the minimum in her state, but she says it's not enough to support her and her young son. She can't afford to buy shoes or fish and rarely eats out. "As long as the authorities are lining their own pockets, the rest of us can all drown," she says. Hirschmann did not comment.

On the campaign trail, Donald Trump vowed to renegotiate the North American Free Trade Agreement, to keep American carmakers and other manufacturers from shifting production to Mexico. Yet tweaking tariffs and rejiggering local-content rules may not do much to stop the sucking sounds of auto jobs moving to Mexico. "Protection contracts are at the heart of the pressure on factory wages in the U.S. and beyond," says Harley Shaiken, a labor professor at the University of California at Berkeley.

The contracts trace their roots to the 1930s, when labor laws allowed unions to initiate a strike at a factory whether it had employee membership at the plant or not, says Héctor Barba, a labor lawyer for the National Workers Union, a CTM rival. This allowed unions to extort money from companies looking to prevent crippling work stoppages, he says. To protect investors, Mexico introduced laws in the 1980s allowing employers to register with one union, thus barring other syndicates from organizing strikes at their plants.

That established a pattern that continues in which a company signs a contract with a union of its choosing as soon as it announces a new project. **Ford Motor Co.** unveiled plans to build a $1.6 billion plant in San Luis Potosí in April 2016; a collective contract was signed in July. It scaled back the investment after Trump called out the company for exporting jobs to Mexico.

Ludwig Willisch, president and CEO of BMW of North America, says his company chose to build its newest plant in San Luis Potosí because auto exports from Mexico have low-tariff or duty-free access to twice as many countries as those from the U.S. When asked if BMW's German union had expressed concerns about wages in Mexico, he answered, "IG Metall worries about what happens in Germany."

That's not what Angélica Jiménez-Romo, an IG Metall board member, says. Her organization "has significant concerns," she says. "Unions in Mexico and the CTM, too, often have mafia-like structures and many are directly linked to the Mexican ruling party. In those unions, workers don't get a say in their wage deals and don't get asked to participate either."

Founded in 1936, with the support of then-President Lázaro Cárdenas, the CTM had a stranglehold on organized labor in Mexico during the more than 70 years the country was ruled by the Partido Revolucionario Institucional (PRI). Although its influence has waned somewhat with Mexico's transition to multiparty rule, the confederation, along with its affiliates, remains a force, with some 4 million members; the National Workers Union claims just 600,000 members. The CTM's current leader, Carlos Aceves del Olmo, is a member of the PRI who's served terms in both houses of Congress. Critics who accuse the CTM of signing protection contracts "don't take into account the fact that workers in Mexico are mature and highly skilled, and when they don't receive the salaries they deserve, they quit," the CTM said in a statement.

BMW spokesman Jochen Frey says, "We checked closely which unions that are present in the San Luis Potosí area, and it was clear very quickly that CTM was the most common one." Frey said the automaker "strives to pay wages that are in the top third level of what's typical for an area," and that Mexico is no exception.

The International Labour Organization, a United Nations agency that monitors labor rights ▶

Global Laggard

Growth in base wages for transportation-equipment workers since 2006

ADJUSTED FOR PRODUCTIVITY; DATA: BOSTON CONSULTING GROUP

◀ worldwide, called on the Mexican government in 2012 to address the issue of protection contracts. A constitutional reform signed into law in February requires unions to prove they legitimately represent workers and shifts responsibility for arbitrating labor disputes from the executive branch to the courts. In an interview, Deputy Labor Minister Rafael Avante acknowledges that the old system "opened the door to vices," which is why the government has for more than a year now been inspecting plants to ensure that workers are aware of their contractual rights. Yet he says allowing employees to vote on contracts isn't desirable, as it could embroil companies in bitter negotiations. "We have to bring order," Avante says.

His boss, President Peña Nieto, has on several occasions boasted that labor tensions have diminished under his watch. "There hasn't been a single strike in a year and a half under federal jurisdiction," Peña Nieto said during a ceremony in 2015 to mark International Workers' Day. He added: "I express my highest regard to unions and worker confederations in the country for this constructive spirit, that without a doubt signals certainty and stability for investors, both national and international." —*David Welch and Nacha Cattan, with Elisabeth Behrmann*

The bottom line Wages in Mexico's auto sector have stagnated because of contracts that give workers no input on pay.

Election Watch

Iranian Voters Want a Share of the Wealth

▶ The nuclear deal hasn't delivered rewards for many of the poor

▶ "Creating jobs, that's what gives hope"


Young Rouhani supporters at an April 29 rally

Aryan, a 26-year-old with a master's degree in engineering, showed impeccable timing when he returned home to Tehran from Canada. It was early 2016, and a decade of economic sanctions was drawing to an end, boosting Iran's economy and kicking off a scramble for the country's small pool of white-collar professionals. The job offers piled up. "Abroad, you're a small fish in a big pond," says Aryan as he unwinds in a garden cafe after a day spent drafting investment strategies for clients of the European consulting firm he works for. (He asked that his last name and the name of his employer be withheld.) "Here, each person can be the first to launch something or become a leader in their field."

The thriving metropolitan upper-middle class that Aryan represents is a natural constituency for President Hassan Rouhani, who's seeking a second term in the May 19 election. The nuclear deal he secured with world powers in 2015 lifted a host of crippling sanctions, drawing \$12 billion in foreign investment and enabling a jump in oil output. Economic growth in Iran rose to more than 6 percent last year, after contracting 1.6 percent the previous year, according to International Monetary Fund estimates.

Yet with the election less than two weeks away, Iran's conservative clerics and their political allies are trying to defeat Rouhani by painting him as a leader who neglected the poor while courting international investors. A victory for Iran's hard-liners could exacerbate already rising tension with the administration of U.S. President Donald Trump.

Six candidates have been approved by Iran's Guardian Council to run in the election, but some may drop out before voting commences. Rouhani's chief opponents include Ebrahim Raisi, a conservative cleric who's widely viewed as the favorite of Ayatollah Ali Khamenei, the country's highest authority. Another is Tehran's mayor, Mohammad Baqer Qalibaf, whose performance in the first of three live televised debates on April 28 lent his candidacy new momentum. Qalibaf assailed Rouhani on air, accusing him of failing to keep his promise to boost employment. "Creating jobs, that's what gives hope," said the candidate, who hails from the conservative Principlist faction. "Investment can come from both abroad and locally. Good management is what's needed."

Efforts to unseat the moderate cleric have been aided by the growing perception that the rewards from the nuclear accord haven't been evenly distributed. In an April survey by IranPoll, 72 percent of respondents said the deal hadn't improved the living standards of average Iranians.

Khamenei has admonished candidates not to campaign on their ability to attract foreign investment, a comment widely seen as a dig at the incumbent. "Rouhani needs in the next two weeks to work on showing that post-sanctions developments will benefit the poor, if not now, then in his second term," says Adnan Tabatabai, chief executive officer

of the Center for Applied Research in Partnership With the Orient, a think tank based in Bonn, Germany.

Hossein, who owns a shop that sells saffron, barberries, and spices in the northeastern city of Torqabeh, Qalibaf's hometown, voted for Rouhani in 2013, but he's considering supporting the Tehran mayor this time around. "I am of two minds," says the merchant, adding that business was better under Rouhani's predecessor, Mahmoud Ahmadinejad.

The former president, whose confrontational style and rhetoric were blamed for the crippling economic sanctions imposed on Iran, championed populist policies at home, including cash transfers for the majority of Iranians. These helped cushion the blow from reductions in fuel subsidies and inflation that soared to more than 40 percent by the time he left office in 2013, as sanctions choked off imports of everything from medicines to oilfield equipment. Qalibaf has proposed more than tripling the monthly payments to low-income Iranians from 450,000 rials ($14) to 1.5 million rials. "If Qalibaf says he'll increase subsidies, then I know for sure the villages will turn out for him," Hossein says.

While Iran's economy got a bump from the lifting of sanctions, the IMF estimates that the nonoil economy, the main engine for job creation, contracted in 2015 and barely grew last year. The fund estimates that unemployment has reached 12.5 percent, up from an average of 10.6 percent in 2014-15.

More than 50 percent of IranPoll respondents said the next president's top priority should be reducing joblessness. Raisi, the conservative cleric, has also latched onto the theme; his campaign tag line is "Dignity and Work."

Foreign-educated Iranians such as Aryan face no shortage of opportunities. Multinationals like **Nestlé SA** and **Siemens AG** that already had a presence in the country are adding staff, while newcomers are desperate for personnel to help them navigate language and cultural barriers. "It's a battle for talent," says Aseyeh Hatami, whose IranTalent recruitment website saw a 110 percent increase in the number of job listings posted by international companies in 2016 from the previous year. ▶

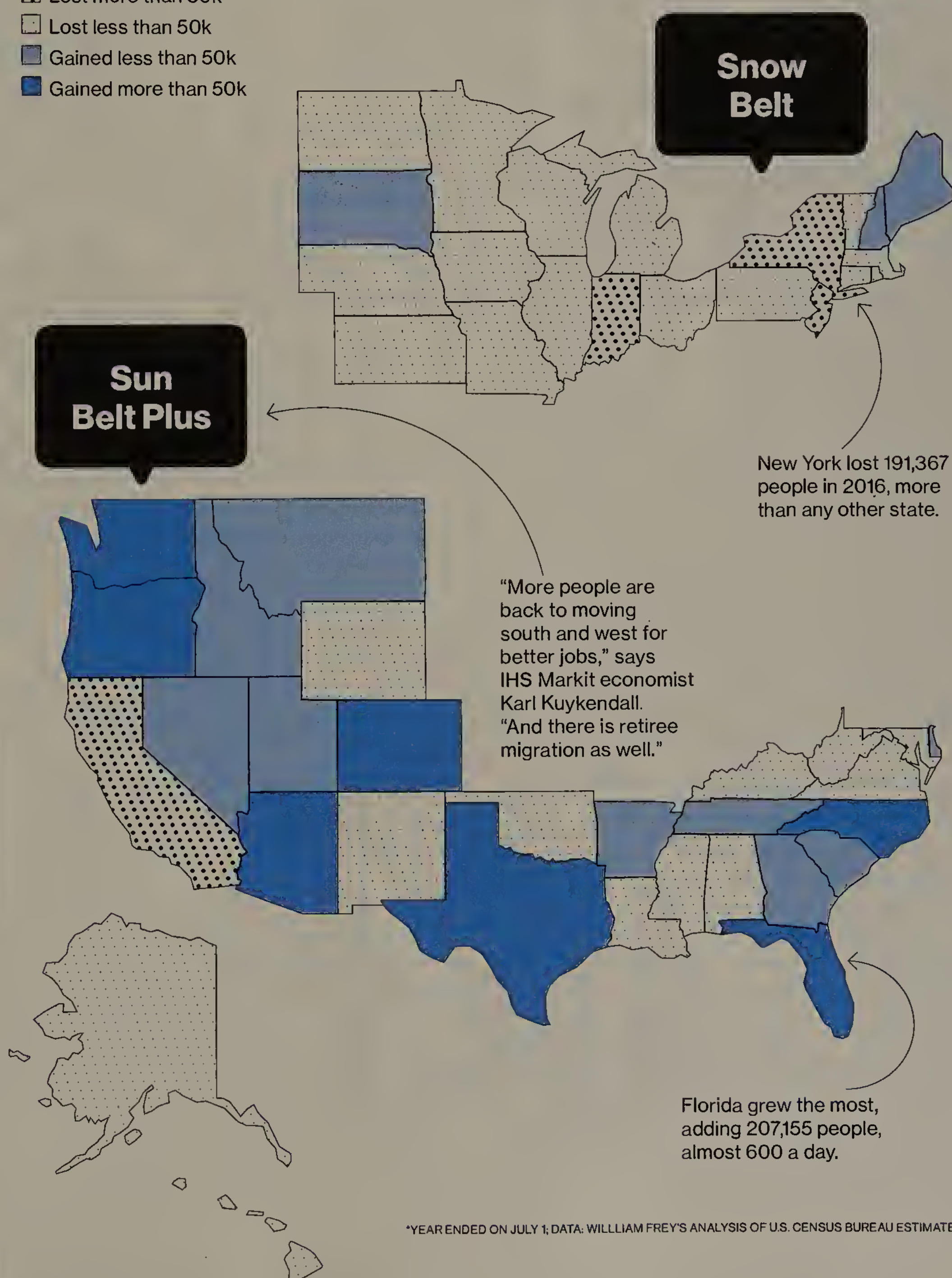
Migration The Sun Belt Rises Again

Almost 600,000 Americans moved to the South and West from the Midwest and Northeast last year, the most since 2005, according to Brookings Institution demographer William Frey. The national recovery has made it easier to relocate. "Think of the recession as freezing people in place—now that is thawing," says Kenneth Johnson, a public policy professor at the University of New Hampshire. —*Steve Matthews*

Moves from the Snow Belt to the Sun Belt

Net domestic migration in 2016*

Lost more than 50k
Lost less than 50k
Gained less than 50k
Gained more than 50k



*YEAR ENDED ON JULY 1; DATA: WILLLIAM FREY'S ANALYSIS OF U.S. CENSUS BUREAU ESTIMATES

◀ Aryan, whose employer also has offices in Dubai, Kuala Lumpur, and Seoul, says he earns a salary comparable to what he'd get abroad. So far he has few regrets over his decision to build a career in Iran. "The boom that everyone expected, an explosion of interest and investment, didn't happen," he says. "But at the end of the tunnel there's still light. Friends abroad email me to say, 'If you see a cool vacancy, let me know.' " *—Ladane Nasseri and Golnar Motevalli*

The bottom line An uneven recovery and rising unemployment bode ill for President Rouhani's chance of securing a second term.

Labor Markets

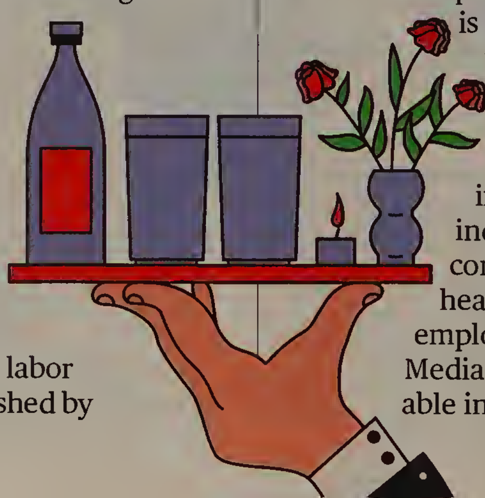
China's Shift to Services Hits a Snag

▶ **Many jobs being minted are menial and pay low wages**

▶ **"Every year, China has more and more college graduates"**

After more than two decades in the factories of the Pearl River Delta making artificial Christmas trees, furniture, and golf clubs, Ji Jiansheng was ready to try something else. A dispute with his bosses over wages was the final straw, so Ji, 38, scraped together his meager savings and opened a restaurant in Shenzhen a little more than a year ago. Now he's up at 5:30 a.m. to buy ingredients for the Shandong-style dishes his small eatery specializes in, and often doesn't hang up his apron until 10 p.m. "I still have to work hard, but I have freedom," Ji says. "It feels much better not having to answer to a boss."

Ji's move from manufacturing into services mirrors a sweeping economic transition being championed by policymakers. The country needs services to become a bigger part of the economy to accommodate new entrants into the labor force, workers being shed by the old smokestack industries, and farm laborers joining the relentless march to the cities. Service industries now employ more than 43 percent of China's 776 million workers, up more than 8 percentage points from 2012, and more than in manufacturing. In developed countries, it ranges between 70 percent and 80 percent.



To spur job creation, the State Council has lowered taxes on service companies, slashed capital requirements for registering enterprises, and encouraged local governments to set up incubation hubs and entrepreneurial parks to support startups. The goal is to create 50 million jobs by 2020.

The strategy is working—to a point. The last time China saw massive factory closures, in the late 1990s and early 2000s, joblessness surged; that's not happening now. The official registered unemployment rate fell to a 14-year low of 3.97 percent in the first quarter. "The service sector is playing a much better role in stabilizing the overall labor market," says Ernan Cui, an analyst at Beijing-based China consulting firm Gavekal Dragonomics.

More and more Chinese are making a living running restaurants, like Ji, or delivering packages or selling goods online. But those occupations hold little attraction for the growing legions of college graduates—almost 8 million this year alone. Despite government incentives, the economy isn't creating enough high-skilled service jobs for software programmers, financial advisers, brand managers, and others.

Albert Park, an economist at Hong Kong University of Science & Technology, recently analyzed census data from 2000 through 2014 and determined that, compared with other developing countries, China had a larger proportion of low-end services and sales jobs, while it lags in professional and technical positions. "If China's goal is all about upgrading the economy, then one might be worried," says Park, who suggests barriers to entry in state-dominated industries such as telecommunications and health care are hindering employment growth.

Median per-capita disposable income didn't grow as fast as the economy in the first quarter, the first time that's happened in the three years the statistics bureau has been releasing the data. One reason may be that workers in service industries often don't have as much leverage in wage negotiations as those in manufacturing. Many lack formal employment contracts and don't have access to the social welfare benefits offered other workers, says Wang Kan, a professor at the China Institute of Industrial Relations in Beijing. For example, almost all delivery couriers and employees of property sales companies—two of the fastest-growing occupations—aren't hired directly but are subcontracted instead, he says, which means "the employer can bypass the labor law."

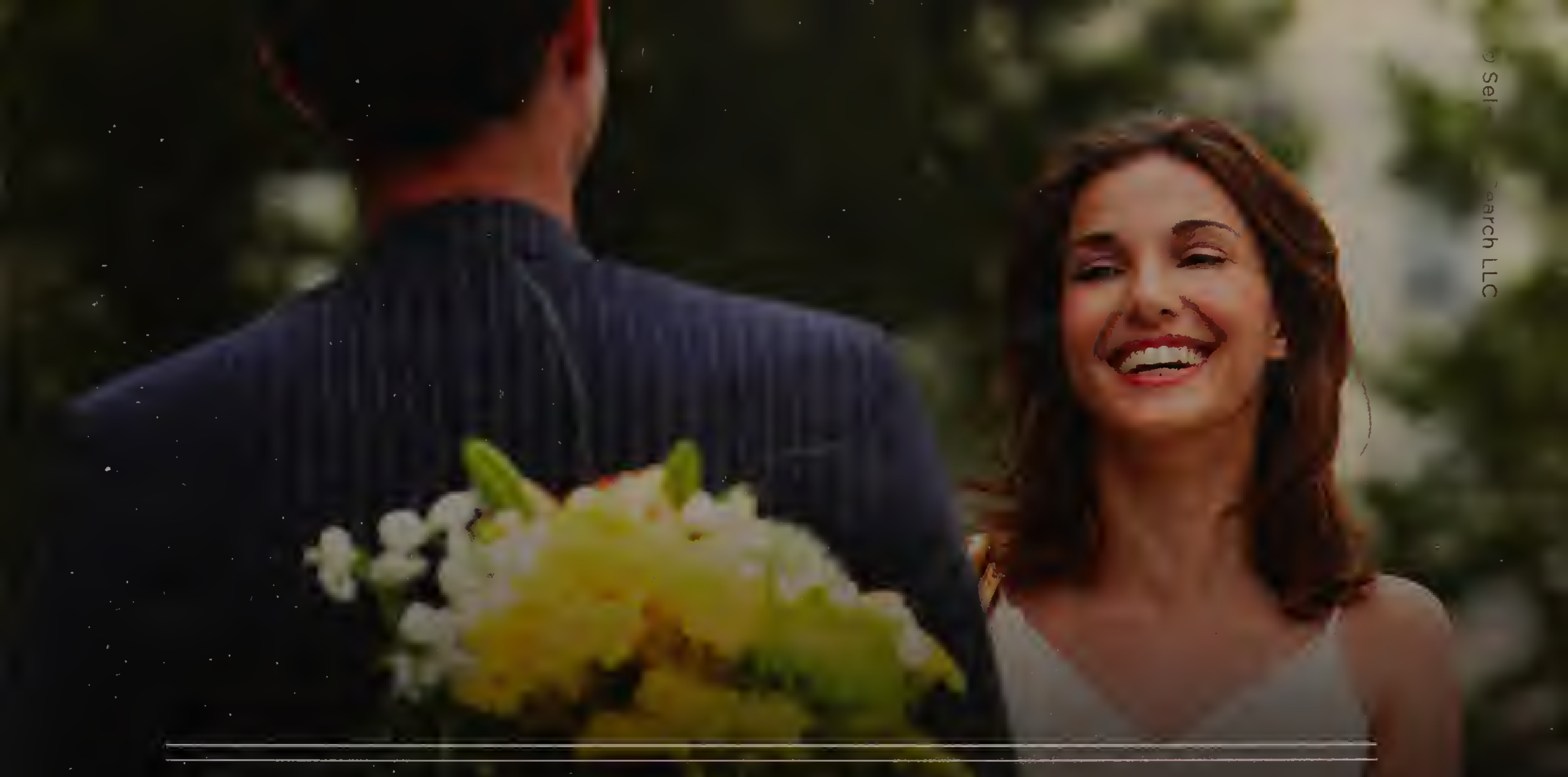
43%

Share of China's labor force employed in service industries; in developed countries it ranges between 70 percent and 80 percent

Agnes Fan, who will graduate from Southwestern University of Finance and Economics next month with an accounting degree, has already lined up her first job, and it's in the service industry: working in the financial department of a district government office in Chengdu, in Sichuan province. The 21-year-old feels fortunate. "It isn't easy to find a job these days. Every year, China has more and more college graduates," she says, adding that some of her classmates have had to accept jobs they dislike while others are still searching. Nevertheless, Fan has mixed feelings—the government position she'll start at in June provides good security, but her dream is to work at one of China's fast-growing internet companies. For now she's looking on the bright side: "At least I don't have to worry about being unemployed." *—Dexter Roberts*

The bottom line Service industries, which employ 43 percent of all Chinese workers, are creating few jobs fit for college graduates.

Edited by Cristina Lindblad
Bloomberg.com



Bloomberg Businessweek May 8 — May 14, 2017

Philippine Casinos Are Cleaning Up

▶ More Chinese high rollers are gambling via phone calls to Philippine casinos

▶ "You can't possibly know your customer, and you can't perform any normal due diligence"

In a VIP room reserved for high-spending gamblers at the City of Dreams Manila casino in the Philippine capital, many of the players are nowhere to be seen. They're not even in the country. They're placing bets by telephone, a practice banned in other gaming centers such as Macau, Singapore, and Australia, but legal in the Philippines. Young men and women dressed in smart black uniforms chat in Chinese over mobile phone headsets, placing wagers on behalf of their long-distance clients. Video cameras on the ceiling broadcast the action on the tables for gamblers who are watching, mostly from China, where transfers of money out of the country are tightly regulated, in part to stem corruption. Remote-control gambling raises the risk that large sums could—often anonymously—be moved off the mainland despite a $50,000 annual limit on such transfers by individuals.

Last year, Philippine casinos reported $27 billion in bets from high rollers. Phone wagering, also known as proxy betting, has grown to account for as much as 85 percent of business at some VIP rooms, according to people familiar with the operations, who asked not to be identified as they're not authorized to speak publicly.

"There's been a huge upswing in players using proxy betting," especially among gamblers in China, says Shaun McCamley, Bangkok-based partner at gaming consulting firm Global Market Advisors LLC. "A customer can sit in the office in downtown Shanghai, call associates of a casino, tell them to place bets, and watch it in real time."

The casinos' fast-growing operations are raising the risks of money laundering, according to a U.S. government report in March. And Philippine gambling operations are causing concern in China, where authorities have sought to halt billions of dollars in outflows that have pushed down the value of the currency and drained capital reserves.

"Proxy betting has always been a huge risk, because you can't possibly know your customer, and you can't ▶

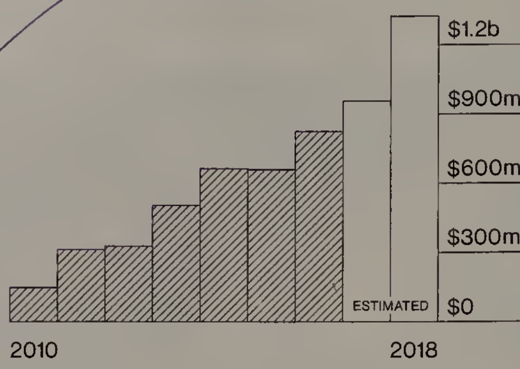
◀ perform any normal due diligence," says David Green, a principal with Newpage Consulting and a former gaming regulator in Australia. "If there are tainted funds, they can be cleaned and issued back to the proxy or the player."

Criminal groups already take advantage of Philippine casinos to transfer "illicit proceeds from the Philippines to offshore accounts," the U.S. Department of State said in its *International Narcotics Control Strategy Report* in March, citing the country's gaming palaces' "high risk for money laundering." Last year, in one of the largest bank thefts in history, a ring of hackers stole $81 million from Bangladesh's foreign reserves that they then routed through a casino, gambling junket operator, and gaming room promoter in the Philippines, according to Philippine government authorities.

While the Philippine Amusement and Gaming Corp. (Pagcor), the casino regulator, permits phone betting, many other gambling centers ban it because of money-laundering concerns. Macau eliminated betting by proxy last year, citing that risk. While banks, insurance companies, and other finance-related companies must comply with the Philippines' anti-money-laundering law, casinos are exempt from reporting requirements—an issue the U.S. State Department's March report called "an especially critical concern."

Not all Philippine casinos engage in proxy betting. Those that do, such as City of Dreams Manila, owned by Macau-based **Melco Resorts & Entertainment Ltd.**, and **Bloomberry Resorts Corp.**'s Solaire Resort & Casino, don't run proxy betting operations themselves. Instead, they rely

Philippines VIP gaming revenue



DATA: MORGAN STANLEY

on so-called junket operators—companies that offer credit to players in China and other countries and employ staff who communicate with them by phone. When gamblers in other countries place these bets through junket operators, their identities are hidden to the casinos, says Global Market Advisors' McCamley.

Bets in VIP rooms accounted for almost half the total of 2016 gaming revenue at Solaire in Manila, the largest casino resort in the Philippines, according to its annual statement. The contribution will exceed 50 percent this year, Morgan Stanley forecasts.

Bloomberry Resorts Chairman Enrique Razon says phone gamblers from China, South Korea, and beyond are contributing to increased revenue, along with growing numbers of Chinese tourists to the Philippines. Bloomberry didn't respond to questions about its anti-money-laundering practices.

At City of Dreams Manila, betting by high-stakes players more than doubled last year, to 327 billion pesos ($6.5 billion), compared with 31 percent growth for mass-market tables that attract casual gamblers.

Melco said in a statement that it complies with the country's anti-money-laundering rules and works closely with Pagcor and the local government on matters that affect the gaming industry.

The total value of bets placed using proxies is higher than the official data from casino operators, according to several people familiar with the Philippine industry. That's because proxy betting makes it easier for gamblers to place side bets with junket operators and agents that aren't recorded. The side bets may total five or six times the reported proxy bets, the people say.

"The agent and the player may agree that while play against the house is denominated and recorded in Hong Kong dollars, they will side bet as if that play had been in U.S. dollars," according to a Global Market Advisors report published in August. "The agent assumes the operational risk or expense of the house in case the player wins, and collects the money in case he or she loses."

The Philippine government is aware of the money-laundering risk posed by proxy betting, according to Andrea Domingo, chairman and chief executive officer of Pagcor. It approves licenses to proxies who can legally help customers bet by phone, and junket operators also need licenses to operate the business legitimately in the country. "Our people are there," Domingo says. "They are watching. We have our monitors, the closed-circuit TVs."

Phone betting isn't the only way the Philippines is trying to attract long-distance gamblers. The regulator has issued 35 licenses for online-betting operations for use solely by foreigners outside the country, Domingo told a Senate hearing in February, saying the government expects to "make a lot of money" from these licenses. —*Daniela Wei and Bruce Einhorn, with Clarissa Batino, Ian Sayson, Cecilia Yap, and Andreo Calonzo*

The bottom line Bets by high rollers at Philippine casinos soared last year, as more Chinese used phone betting to gamble remotely.

Apparel

How a 70-Year-Old in Nerdy Shoes Got Cool

▶ **Adidas is profiting from a star-fueled comeback for Stan Smiths**

▶ **"We want a consumer to buy three or four or five pairs"**

Adidas AG aims to increase its sales by 40 million pairs of sneakers annually, to more than a half-billion by 2020, largely by appealing to fashion-conscious teens and urban hipsters. At the heart of that effort: a decades-old shoe named after

a retired tennis player who lives in South Carolina and hasn't won a major singles tournament since 1980.

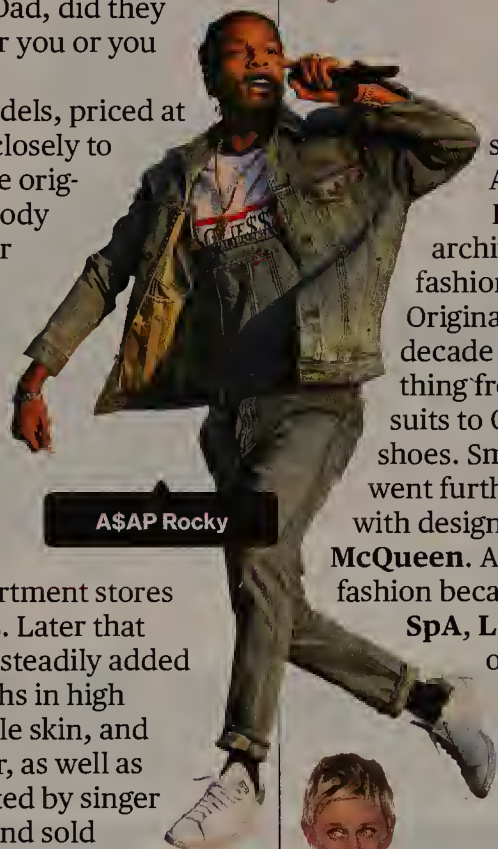
The shoe is the Stan Smith, a white-leather number with pale green accents introduced in 1971, the year before Stan Smith (the player, now 70) earned his second and last Grand Slam singles title. Thanks to a well-orchestrated promotional blitz, this unlikely hero has made one of the greatest comebacks in marketing history, from a declining brand popular with suburban dads into a must-have for the fashion-savvy. As they rev up an effort to catch **Nike Inc.**, Adidas executives are seeking to replicate parts of the campaign to stoke interest in other shoes. "We wanted to position it anew with fashion designers and trendsetters," says Arthur Hoeld, who heads Adidas's brand strategy and business development. "This is part of the concept—to push boundaries, to experiment."

As Adidas was planning the Stan Smith revival about five years ago, the shoe was still selling, though it was showing up more often at discount stores. The feeling around the company was that the model had lost its mojo, but Hoeld and a handful of other executives saw its potential, their confidence bolstered by reports that Phoebe Philo, creative director of the Céline fashion house, had been spotted sporting Stan Smiths at her shows. So Hoeld's team outlined a campaign designed to look grassroots but which was in fact choreographed from start to finish with a goal of making the shoes de rigueur for people whose parents may be too young to recall the last time Smith played at Centre Court.

The first step was counterintuitive: Adidas pulled the shoe from the market in 2012, leaving customers with the impression that the move was permanent. By mid-2013, Stan Smiths were almost impossible to find, prompting angry letters from fans—and spurring Smith and some on Hoeld's team to question the wisdom of the plan. Late that year, Adidas began shipping a new version to dozens of celebrities it had worked with, including singer A$AP Rocky, designer Alexander Wang, and talk-show host Ellen DeGeneres. The freebies included a personalized touch intended to get the stars to wear them: A drawing of Smith on the tongue was replaced by an image of each recipient. Adidas struck gold in November 2013, when French *Vogue* featured model Gisele Bündchen sporting nothing but a pair of white socks—and Stan Smiths. About the same time, Adidas released a two-minute web video featuring actors and sports stars waxing poetic about the sneakers. "People think I'm a shoe," Smith laments in the clip, recalling that his son once asked, "'Dad, did they name the shoe after you or you after the shoe?'"

Stan Smith

The first new models, priced at about $90, hewed closely to the simplicity of the original, with a white body and a touch of color on the tongue and heel. In early 2014, Adidas started shipping them to shops catering to hardcore sneaker fans, followed by specialty footwear retailers and, months later, department stores and big-box outlets. Later that year, the company steadily added spinoffs—Stan Smiths in high heels, faux crocodile skin, and honeycomb leather, as well as 10 pairs hand-painted by singer Pharrell Williams and sold at the **Colette** fashion boutique in Paris for €500 ($545). In 2015, Adidas introduced variants aimed at specific age groups and tastes: simulated ostrich leather, Velcro closures, white with pink accents, blue pony hair heel tabs—even one featuring Kermit the Frog. "We want a consumer to buy three or four or five pairs," says Eric Liedtke, Adidas's global brand chief.

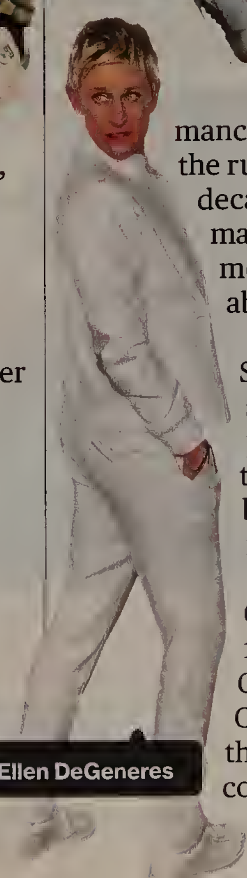


A$AP Rocky

Adidas aims to increase revenue to more than €25 billion in 2020, from €19.3 billion in 2016. The Stan Smith is leading the way. Sales of the shoe jumped dramatically, to 8 million pairs, in 2015, bringing total sales over the past four decades to more than 50 million. While the company hasn't released figures, researcher NPD Group Inc. estimates U.S. sales rose fivefold last year.

Adidas says sales of its Originals collection, which includes the Stan Smith and another top-selling retro model called the Superstar, popularized by rappers Run-DMC, increased by 80 percent in the U.S. last year, more than three times faster than footwear for team sports such as basketball and American football.

Dipping into the archives isn't rare in sports fashion. Adidas created the Originals line more than a decade ago, selling everything from shiny '70s track suits to Gerd Müller soccer shoes. Smaller rival **Puma SE** went further by collaborating with designers such as **Alexander McQueen**. As the concept of sports fashion became ubiquitous—**Prada SpA**, **Louis Vuitton**, and other brands now sell luxury sneakers—Puma alienated serious athletes looking for shoes aimed more at improving performance on the track than the runway. Over the past decade, Puma's profit margin has collapsed from more than 25 percent to about 5 percent today.



Ellen DeGeneres

As sales of the Stan Smith and the Superstar start to wane, Adidas plans to pump up other throwbacks from the back of its closet: the 1950 indoor soccer shoe Samba, the suede Gazelle dating to the 1960 Rome Summer Olympics, and the Campus, worn by one of the Beastie Boys on the cover of 1992's *Check* ▶

World of Wonder Life's a Drag

RuPaul's TV show has scored with a formula that pits fierce, larger-than-life drag queens against one another in a competition à la *Survivor.*


RuPaul

Film school buds Fenton Bailey and Randy Barbato fell in love with the art of drag in New York's East Village in the 1980s. "It deserved a bigger audience," Bailey says. Fast-forward 30 years, and *RuPaul's Drag Race*—the hit show made by the pair's company, World of Wonder Productions—has brought one. Along with RuPaul, WoW produced DragCon in Los Angeles on April 29-30. Part fan fair, part trade show, the event was a testament to the appeal of drag to the masses. Says Barbato: "We have always been about the democratization of all media." —*Anousha Sakoui*

87m
Number of cable households *Drag Race* reaches now that WoW has moved the show from Logo TV to VH1, almost doubling its potential audience.

1m
Number of viewers that tuned in to the ninth season premiere on March 24, tripling VH1's previous ratings for the time slot.

40k
Attendance at the third DragCon in Los Angeles in April, which drew families, too. WoW will launch a sister drag confab in New York.


KidZone


Detox, a hit on *Drag Race*'s fifth season, will get her own show on WoWPresents' YouTube channel, which has almost 700,000 subscribers.

◀ *Your Head*. Adidas has "great retro shoes in the vault," says NPD analyst Matt Powell. And at least one former skeptic has come around to the idea. "I thought there was no way 14- to 24-year-olds would relate to me, so I thought it was a bad strategy," Smith says. "I've been proven wrong. Big time." —*Richard Weiss*

The bottom line Three years into the successful relaunch of Stan Smith sneakers, Adidas is studying how to create similar buzz for other shoes.

Education

Kaplan Sells Its College But Keeps Its Profits

▶ **It will still manage the online school for buyer Purdue University**

▶ **"We thought it would be a bad idea for us to build this on our own"**

How do you turn a for-profit college into a nonprofit? Partner with a public university—and pay $50 million for the privilege. That's basically what happened on April 27 in a deal between for-profit higher-education chain Kaplan and Purdue University, the public Indiana college.

The arrangement may help Kaplan parent **Graham Holdings Co.** escape the for-profit education industry's tarnished reputation. Purdue paid Graham a symbolic $1 to expand the university's reach by adding online degrees that target older Americans—many of them minorities—who are unable to attend conventional schools. "We thought it would be a bad idea for us to build this on our own," says Mitch Daniels, the former Indiana governor who's now Purdue's president. "We've seen a lot of schools throw a lot of money at online education without much result."

Under the contract, Graham will transfer Kaplan University's online programs, as well as its 32,000 students and 15 campuses and learning centers, to a Purdue-owned nonprofit venture. Kaplan will then operate the venture and guarantee that Purdue will for five years receive at least $10 million annually. After covering that payment and Purdue's related operating costs, Kaplan is entitled to reimbursement for its own cost of providing services, plus a fee equal to 12.5 percent of the Purdue affiliate's revenue.

Kaplan reported $617 million in revenue last year and almost $67 million in operating income. Its 3,000 academic staffers will join the Purdue-owned venture. In a statement, Graham said Kaplan and Purdue "share the critical mission of expanding access to education." The deal doesn't include another Kaplan business, its well-known test-prep unit.

Critics have said such arrangements help operators of for-profit colleges avoid regulatory crackdown. "To me, that's Kaplan buying the Purdue name to run their college," says Bob Shireman, a former deputy undersecretary of education in the Obama administration.

Daniels looked carefully at Kaplan's background, and the company had "by far the best record we could find in the industry," he says. "As soon as I learned Kaplan was looking to exit the for-profit space, I quickly centered on them." Daniels says "the academics will be under our guidance," while Kaplan will provide "back-office services," including recruiting and marketing.

Kaplan was once the crown jewel of Washington Post Co., as its fast-growing colleges helped support the financially struggling newspaper. In 2013 the company sold the *Post* to **Amazon.com Inc.** founder Jeff Bezos and renamed itself Graham Holdings, after the Washington family that had long controlled it. Donald Graham, then Post Co. chief executive officer, is chairman of Graham Holdings.

For-profit colleges such as Kaplan have seen their fortunes dim amid scrutiny from Congress and state and federal authorities because of aggressive marketing, high costs, and job placement claims. For-profit schools' revenue comes mostly from federal loans to students, and those borrowers have long had higher default rates than those at nonprofit colleges and universities.

Online offerings from public universities—including Arizona State University, which has a partnership with **Starbucks Corp.** to offer degrees to its employees—have also proved to be stiff competition for for-profits.

-14.5%

Enrollment drop at four-year for-profit schools in fall 2016 from a year earlier; nonprofits' enrollment fell less than 1 percent

Kaplan has been "operating under a terrible cloud" as part of the for-profit sector, says Trace Urdan, an analyst who recently left Credit Suisse Group AG, so converting to a nonprofit structure may burnish its reputation. There also are financial benefits, because nonprofits are exempt from most taxes, says Shireman.

Since the election of Donald Trump, who promised on the campaign trail to reduce government involvement in education, shares of publicly traded companies in the industry have surged. While the S&P 500 index has gained 13 percent since the Nov. 8 election, Graham Holdings shares are up 35 percent.

Trump University, Trump's for-profit company that offered real estate seminars, reached a settlement for $25 million in November in a lawsuit alleging it defrauded its customers and illegally called itself a university.

Kaplan isn't the first battered for-profit to seek shelter in nonprofit status. Publicly traded **Grand Canyon Education Inc.**, which operates Grand Canyon University in Phoenix, a Christian school, announced in 2014 that it planned to buy out shareholders and convert to a nonprofit. The school dropped the plan last year after its accrediting body raised questions about the deal.

At least four schools have completed the transition to nonprofit. The most recent deal came in March, when for-profit **Education Management Corp.** agreed to sell most of its career colleges to the Dream Center Foundation, a Los Angeles nonprofit that trains people for the high school equivalency exam. Dream Center then hired the former chairman of Grand Canyon to manage the schools. —*Laura Colby*

The bottom line For-profit colleges are taking heat. So some are converting to nonprofit status, while keeping some operating practices intact.

Edited by James E. Ellis and David Rocks
Bloomberg.com

Bloomberg Businessweek May 8 — May 14, 2017

Tax Cuts. As Easy As

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▶ The math behind Trump's plan to cut taxes does not compute

▶ "What you're implicitly proposing is lower spending and higher taxes in the future"

There's a reason Treasury Secretary Steven Mnuchin keeps insisting that his boss's tax-cut plan will fully pay for itself through faster economic growth. Budgetary politics make it hard for him to say anything else. Senate rules require 60 votes for any tax cut that would raise deficits beyond a window of 10 years from the date of passage. Conceding upfront that President Donald Trump's plan would generate more red ink in the medium to long term would be accepting defeat before the legislative fight has even begun.

"This will pay for itself with growth and with reduction of different deductions and closing loopholes," Mnuchin said at an April 26 briefing on the one-page outline of a tax plan. National Economic Council Director Gary Cohn didn't go that far, though he did call the plan "a once-in-a-generation opportunity to do something really big."

Math is not on their side. The budgetary impact of tax legislation is scored by the nonpartisan staff of Congress's Joint Committee on Taxation. Judging from its past calculations, the JCT is likely to agree with independent budget wonks, on the left and right, who have concluded that Trump's plan would create a gusher of red ink. "No individual tax cut pays for itself," says Alan Cole, an economist at the right-of-center Tax Foundation. "There has to be a strong mix of tax cuts and revenue-raisers–a good mix of both candies and vegetables. Right now I see things as a little short on vegetables."

The Trump tax plan, because it generates deficits as far as the eye can see, violates what's known as the transversality condition, which says that debt relative to the size of the economy cannot grow to infinity; fiscal policy is sustainable over the long run only if there will be surpluses in the future to offset deficits today. True, Keynesian-style tax cuts like President Barack Obama's 2009 stimulus package also generate red ink, but they're designed to phase out when the economy no longer needs the jolt.

What makes the Trump tax cuts violate the transversality condition is that they're intended to be permanent. "If you propose a big tax cut without offsetting spending cuts, then it's essentially an incomplete proposal," says Eric Toder, co-director of the Tax Policy Center, a venture of the Urban Institute and Brookings Institution. "What you're implicitly proposing is lower spending and higher taxes in the future."

The federal budget was on the wrong track even before Trump took office. The Congressional Budget Office said on March 30 that, assuming current laws remain generally unchanged, federal debt held by the public would grow from 77 percent of gross domestic product now to 146 percent in 2046, with no end to the upward trend on the horizon. That's unsustainable. "We have this enormous fiscal gap. We have to be cutting it, not raising it," says Laurence Kotlikoff, a Boston University economist who harped on deficits when he ran for president last year as an independent.

Since Trump can't credibly claim that his tax cuts will pay for themselves and not increase the deficit, he's left with unpleasant options. One is to curtail his cuts in hopes of achieving a score of revenue neutrality from the JCT. He's already dropped hints that he considers the one-pager as a starting point for negotiations, not a final demand. But while taking candy out of the tax package and adding vegetables

The good times are back—for now—in coal country 28

This equation is the **transversality condition** for a government budget. Debt is B, the present time is t, the economy's growth rate is g, the future time period is s, and infinity is ∞. What all this means is that the present value of government spending has to be matched by the present value of all receipts...

$$1+g)^{s+1} \leq 0$$

... in other words, Trump's tax plan is unsustainable.

would please the JCT, it would make it harder to pass the bill by creating some clear losers: If revenue is to be neutral, inevitably there will be groups whose taxes go up—such as New Yorkers and Californians who would lose the ability to deduct state and local income taxes.

A second option is to schedule the tax cuts to expire by the end of the JCT's 10-year scoring period, so they can pass with a simple majority in the Senate. That's what President George W. Bush did, although some of his cuts were later extended. But businesses don't like to make investment decisions based on tax cuts that won't last.

A tempting alternative is for Congress to change its rules. Senator Pat Toomey, a Pennsylvania Republican, issued a press release on April 26 disdaining "arbitrary budget constraints" and suggesting that it might not be necessary to make Trump's tax plan revenue-neutral at the end of 10 years. "There are ways to navigate these obstacles," the statement said, "including the use of a longer horizon," meaning more time for cuts to generate growth and become revenue-neutral. The *Wall Street Journal* reported on May 2 that a senior administration official said in late April that no rule requires the window for scoring tax proposals to be 10 years long. A scoring window of 20 or 30 years wouldn't magically make a deficit-generating tax cut into a surplus-generating one, but it would please businesses by giving them low tax rates for longer.

A third option is to press hard on the argument that any revenue losses are temporary and will be made up as the tax cuts boost economic growth. This is Mnuchin's case. Likewise, Vice President Mike Pence said on *Meet the Press* on April 30 that deficits could grow "maybe in the short term," but added, "If we don't get this economy growing at 3 percent or more, as the president believes that we can, we're never going to meet the obligations that we've made today."

Pence is right that stronger growth would solve a host of problems. This is where things get interesting. Suppose that Trump's tax cuts raise economic growth over the long term, just not enough to fully pay for themselves. Deficits would rise. But if—hypothetically—debt grew more slowly than the economy, debt would shrink in relation to GDP, making it easier to bear. The tax cuts, despite not being revenue-neutral, would bring the budget closer to satisfying the transversality condition—i.e., being sustainable.

Mnuchin hinted at one point in the April 26 briefing that debt sustainability, not revenue neutrality, was the right standard by which to judge Trump's tax cuts. He said that "this plan is going to lower the debt-to-GDP" ratio. Expect to hear more of that kind of talk in future GOP messaging. —*Peter Coy*

The bottom line Trump's plan to cut taxes might lead to higher GDP growth, but without spending cuts it will certainly increase the deficit.

Climate Change

New Jersey Builds Walls Against a Rising Tide

- **Federal funds to buy out owners' flood-prone homes go unspent**
- **"You either fortify yourself and stay or tell people to leave"**

On a recent rainy afternoon near the Jersey Shore, John Spodofora, the mayor of Stafford Township, stood at the edge of the water and pointed to a spot in the salt marsh where he wants to build a giant berm to blunt the force of hurricanes. Stafford is on the western side of Barnegat Bay, the 40-mile body of brackish water north of Atlantic City that's surrounded ▶

◀ by blue-collar bungalows, cheap motels, and oceanfront mansions. In 2012, Stafford took a direct hit from Hurricane Sandy, which destroyed 3,000 of its homes. Rather than leave, most residents chose to rebuild.

The berm project would cost as much as $100 million, money the town doesn't have. Spodofora is hoping the federal or state government will fund it, even though most of the 5,000 homes the berm would protect will likely be underwater in a few decades with or without it. Still, Spodofora is committed. "There's no areas of my town that I can say aren't worth protecting," he says.

In coastal New Jersey, the debate about whether the climate is changing has been superseded by a more urgent question: What to do about it? While local officials such as Spodofora want to build walls against rising seas and fiercer storms, environmentalists say that delays the inevitable. The best policy, they say, is to encourage people to move inland and let the most vulnerable areas disappear into the water.

They may have found allies in the Federal Emergency Management Agency. After spending more than $278 billion on disaster relief over the past decade, the agency has begun to consider a change in tactics. In March, Bob Fenton, FEMA's acting administrator, told a meeting of state emergency directors that governments need to find ways to reduce risk. "We need to move out of threatened areas," he said. New Jersey shows just how hard that will be.

Sea levels along the Jersey coast are projected to rise as much as a foot by 2030 and close to 2 feet by 2050, according to a 2016 report by Rutgers University. By 2100, if greenhouse gas emissions continue at the current rate, more than three-quarters of the property, by value, in some towns will be underwater. "The only thing that's going to be around in 50 years, on a high tide, are the bridges," says Ken Able, director of Rutgers's marine field station, housed in a converted 1930s U.S. Coast Guard station at the southern tip of the bay. Able says the road to the station floods so often that Rutgers will eventually have to move the building.

On Long Beach Island, across the water from Stafford, Joseph Mancini, mayor of Long Beach Township, has told homeowners on the bay to expand the steel walls at the edge of their property, from 5 feet above the water to 7. "By raising the bulkheads 2 feet, I kind of figured we'd be good for 40-plus years," says Mancini. But that just covers the bay side of town.

$23m
The cost of this 3.5-mile steel wall built after Sandy

On the ocean side, the Army Corps of Engineers just finished a 14-mile, 300-foot-wide system of dunes and berms that cost $232 million, fully funded by the federal government. In May the Corps will start work on a second 14-mile dune-and-berm project north of here, with a total estimated construction and maintenance cost of $507 million. "It's a hell of a deal," says Mancini, who had to win over skeptical beachfront homeowners worried the dunes would spoil their ocean view.

Tim Dillingham, executive director of the American Littoral Society, a New Jersey environmental group, says it's a mistake to focus on building walls. For one thing, rising sea levels cause streets to flood from underneath as storm drains back up, which walls can't prevent. Walls are expensive, they speed erosion of beaches, and, maybe worst of all, they create a false sense of security. "The fundamental ecological idea that people cannot get through their heads is that coastal systems are dynamic," says Dillingham. "You cannot hold them in place, which is what all this is about–trying to hold them in place so we can have houses on them."

He says a better solution is a deliberate retreat: emptying and demolishing homes in waves, gradually moving the edge of development backward as the water moves forward. Just as the wetlands migrate over time, so must the inhabitants. The trick will be persuading people to leave.

After Sandy, the federal government gave New Jersey $300 million to buy homes vulnerable to storms and flooding. Under the program, called Blue Acres, willing homeowners get the pre-Sandy value of their home, which is then demolished, leaving the land undeveloped. But for homeowners to participate, their local government needs to agree to take part. And so far, many haven't. Four years after it started, Blue Acres has spent just half the money available. Around Barnegat Bay, it has yet to buy a single home.

"The only thing that's going to be around in 50 years, on a high tide, are the bridges"

Local officials offer different explanations for resisting. Mancini, whose other job is building houses, says homes in his town are too expensive to justify buyouts. Spodofora says his residents weren't interested, and even if they were, the loss in property tax would hurt his budget. "Is the government gonna have to buy every piece of property?" asks Thomas Kelaher, mayor of Toms River, the largest city on the bay. "You either fortify yourself and stay or tell people to leave. And telling them to leave, I tell you, will never work."

The day after Spodofora toured his shoreline, parts of Stafford Township flooded. This happens more often than it used to. In the neighborhood called Mallard Island, a set of winding streets less than a foot above the bay, Maryann O'Neill describes the water that had completely submerged the area in front of her house as "minor tidal flooding." O'Neill expects she'll have to sell soon and worries the increased flooding will deter buyers. Across the street, Joe and Diane Rowan stood on the part of their driveway that wasn't underwater and half-joked about reaching their house by kayak. Still, they say they're not worried about the sea-level rise. "That's so many years away," says Diane. Projections from Rutgers indicate the neighborhood could be permanently underwater as soon as 2030.

Down the road, Jim Brennan sat in a plastic chair between the pilings holding up the house he's lived in since 1970 and stared at the bay. He says ▶

O'Neill, outside her house, looking at what she calls "minor tidal flooding"

◀ it isn't unusual to be stuck for days when the flooding gets bad. The town has tried to help, elevating roads and improving storm drains. But those steps only do so much. "It doesn't change that," says Brennan, pointing out at Barnegat Bay, its gray waters slowly rising, gathering force for the next storm. —*Christopher Flavelle*

The bottom line More than four years after Sandy, coastal New Jersey is building walls rather than buying out owners of the most vulnerable homes.

Energy

In Coal Country, Signing Bonuses Are the Buzz

▶ **Rising prices fuel optimism in Appalachia. But will it last?**

▶ **"Mainstream investors are now looking at coal again"**

Before dawn on Friday, April 7, a miner named Cameron Justice stopped at a gas station in Mingo County, W.Va., to grab two cans of Monster Energy drink before heading underground. He could use the jolt. The barrel-chested 37-year-old works six eight-hour shifts a week at the Ruby Energy mine in the heart of West Virginia coal country. Last year he was lucky to get four shifts. "We're booming," Justice says. "This is the biggest upswing I've seen in five years. Everyone's excited."

Prices have tripled in the past year for metallurgical coal, which is used in steel production and is abundant in southern West Virginia but hard to find elsewhere in North America. The state has plenty of thermal coal, too, the kind used in power plants. Prices for that in Central Appalachia are up 19 percent in the past year. Despite Donald Trump's anti-regulation, pro-coal policies, rising coal prices have less to do with the president and more to do with market forces.

Last year, China cut domestic coal production in an attempt to raise prices. Then in March, a tropical cyclone hammered Australia's coast, disrupting global supplies and making U.S. coal more valuable. That's spurred fresh investment from Wall Street and slowed what's been a generation-long decline in Appalachian coal country.

Coal output in southern West Virginia has shot up in the last year

In Logan, W.Va., a town of 1,800, where once-bustling streets are blighted with shuttered stores and cracked sidewalks, the gossip is no longer about mine closures and layoffs. It's about miners again getting $1,000 signing bonuses, fully paid health insurance, and raises. Justice just earned a 50¢-an-hour bump.

Local governments in southern West Virginia, starved of cash in the past few years, are expecting higher coal-related tax and royalty payments will help plug budget holes and pay for much-needed infrastructure. "This is a tremendous deal," says Danny Godby, president of the Logan County Commission, which slashed the county budget by 10 percent this year, to $11.4 million. "In the near future, we're going to get that base back." Godby wants to use the influx of cash to build roads and wastewater systems to lure noncoal industries. He has his sights on hog farms, a chicken factory, and tourism tied to the Hatfield-McCoy Trail system used by all-terrain vehicle enthusiasts. "We're trying to diversify," he says. "We want to generate a firmer tax base."

From 2008 to 2016, annual production from West Virginia's southern coalfields fell from 117 million tons to 36.6 million, according to the U.S. Mine Safety and Health Administration. Competition from China, as well as from cheap natural gas, which has challenged coal as the top source of electricity in the U.S. in the past three years, drove some of America's biggest mining companies into bankruptcy. With coal prices up, companies that reorganized have come back stronger. In the past year, the market value of all publicly traded U.S. coal companies has doubled, to $15 billion.

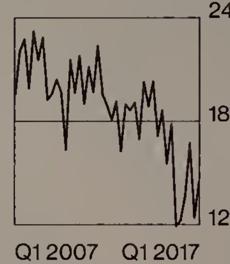
Through mid-April, coal output rose 9 percent in southern West Virginia from a year ago, according to the U.S. Energy Information Administration. That's the first annual rise in nine years. It's hard to tell how much, if any, of that is due to Trump. He's rolled back much of Obama's climate policies, promised fewer environmental regulations, and opened more federal land to coal mining. That's at least brightened expectations on Wall Street for U.S. coal supplies.

Since Trump took office, two coal companies have gone public, raising a total of half a billion dollars. In February, **Ramaco Resources Inc.**, backed by private equity funds **Energy Capital Partners** and **Yorktown Partners LLC**, held the coal industry's first initial public offering in two years. **Warrior Met Coal Inc.**, whose largest investor is **Apollo Global Management LLC**, followed suit in early April. "Mainstream investors are now looking at coal again," says Jeremy Sussman, a mining analyst with Clarksons Platou Securities Inc. "Six months ago, that wasn't the case."

In December, Ramaco opened a new mine in Logan County. When it held a job fair in March to fill about 40 spots, more than 850 people showed up. Competition for highly skilled workers, such as mechanics and electricians, has grown so fierce that companies are covering workers' health-care premiums. **Bluestone Industries Inc.** recently offered signing bonuses as high as $1,000.

U.S. coal production

Millions of short tons



A few miles up the road from the town of Logan, in a sleek convention center on a restored mountaintop that had been flattened by surface mining, Paul Lang, president of the nation's second-biggest coal company, St. Louis-based **Arch Coal Inc.**, recently gave a cautious presentation on coal's future. Lang outlined how Trump can help by easing regulations and promoting infrastructure spending. But there's a bigger problem: China, more than Trump, spurred this revival, he said, and natural gas will continue to be the fuel of choice for U.S. power plants. "Why did Logan County get hit so hard? The answer's right there," he said, showing a chart depicting gas's rise and coal's collapse. "It's going to be hard to bring that back." —*Tim Loh*

The bottom line Prices for West Virginia's metallurgical coal have jumped, but market forces, not Trump policies, are the reason.

Edited by Matthew Philips
Bloomberg.com

Microsoft Surfaces

▶ In three years, the company has gone from gadget also-ran to innovator

▶ "Remember, I am also the person who went through the writedown"

Starting about three years ago, **Microsoft Corp.** hardware chief Terry Myerson began showing a slide during meetings with the company's board, executives, and his team. It depicted a classroom full of college kids, all using **Apple Inc.** products. Myerson's message was simple enough: The company needed to make drastic changes or risk losing the next generation of customers to its longtime rival.

On May 2, Microsoft unveiled a sleek, lightweight laptop that looks every bit as good as anything Apple has built. The machine, which boots up in seconds and runs a new version of Windows, is the latest product to appear under the Surface brand, which includes a popular line of tablets and an all-in-one desktop. Myerson is betting the laptop will help persuade Mac loyalists to give his company a try. Microsoft is targeting college students it believes are eager for a premium, $1,000 laptop they can use for four years without worrying that it will become obsolete before they graduate.

The Surface Laptop will go on sale next month, and it's too soon to predict how it will fare. But that it exists at all is testament to a remarkable comeback for Microsoft's hardware business. Decisions made in 2012 and 2013 yielded a depressing body count—almost $9 billion in writedowns, tens of thousands of firings, infuriated partners, frustrated investors, and the breakup of Bill Gates and Steve Ballmer's 40-year bromance, which Ballmer says disintegrated in part because of his push into hardware.

Under Myerson and Chief Executive Officer Satya Nadella, Microsoft has taken a more disciplined approach to hardware, focusing largely on uncrowded segments or creating categories, including the company's HoloLens mixed-reality goggles, which project virtual objects into your view of the real world. Everything else the company leaves to partners such as **Dell**, **Lenovo**, and **HP**. The Surface brand generated more than $4 billion in sales for the fiscal year ended June 30, 2016. "We have grown up so much in the last two years," says Yusuf Mehdi, head of marketing for hardware and Windows. "It's night and day."

Microsoft hasn't entirely mastered hardware. Sales for the quarter ended in March fell short because Surface revenue declined 26 percent from the same period a year earlier. The ▶

◀ company had expected a dip because its Surface Pro models are aging, but the decline was more drastic than executives anticipated. It's a reminder that a company relatively new to the computer hardware market needs to figure out how often to refresh its product lineup and how much to cut prices to move old inventory.

Microsoft's emergence as a hardware player coincides with a perceived lack of innovation at Apple, where Macs have been taking a back seat to the iPhone. It's been almost seven years since Apple redesigned the MacBook Air, the computer most similar to Microsoft's laptop. The latest MacBook Pro, released more than 500 days after its predecessor, was panned by professionals, who deemed it underpowered and hard to use. Apple recently acknowledged it had alienated Mac loyalists and pledged to do better. The upshot: Microsoft has an opportunity to snag some of those customers.

When Nadella became CEO in February 2014, it wasn't clear Microsoft should be in the hardware business at all. About a year earlier, the Surface RT tablet had flopped. Successive products did little better, and Microsoft could no longer rely on its Windows monopoly, because consumers had abandoned the PC for tablets and smartphones. Nadella needed to find a way to remain relevant.

At the time, the hardware team was preparing two tablets for a spring release: the Surface Mini and an improved version of the Surface Pro, a category-busting machine that included a keyboard and detachable screen. Nadella told them the next device was make or break. "His point was, this product has to be great," says Panos Panay, who oversees Surface products. "This is either our entry to or exit from the hardware business."

The team killed the Surface Mini because it wasn't sufficiently different from what was already out there. Instead, they focused on the other tablet, which became the popular Surface Pro 3. Nadella ordered faster development of a top-secret project that eventually became HoloLens, an entirely new category.

Nadella also made significant operational changes. First he acknowledged the purchase of **Nokia Corp.**'s handset unit was a failure. He fired more than 15,000 people, wrote down the acquisition, and largely exited the phone business. Then he handed the remains of the hardware unit and its demoralized workers to Myerson, who was already charged with reviving Windows. Software and hardware engineers and designers were told to work in tandem to improve the overall user experience, an approach pioneered at Apple decades ago.

Industrial designers once relegated to a parking garage were moved into their own building. There, they use advanced 3D printers and computer-controlled machines to rapidly build prototypes until everything is right. In one wing, which resembles a biology classroom, with skulls, a skeleton, and a 36-camera scanning rig, the team tests gadgetry ergonomics on variously sized heads, wrists, and bodies. Microsoft refines the audio in an "anechoic" chamber that absorbs sound so effectively that Guinness World Records rated it as the quietest place on earth. The new Surface laptop required extensive testing because it dispenses with speaker holes, instead transmitting sound via a keyboard made from porous fabric.

Before long, Microsoft began turning out sleek, brushed-metal machines that, while hardly revolutionary, were inventive and consumer-friendly. With the Surface Dial, a $100 standalone wireless knob that went on sale last fall, users can do things such as adjust their Surface's sound and other settings or zoom into blueprints and other files. The Surface Studio has a 28-inch screen that can fold down to create a digital drafting table.

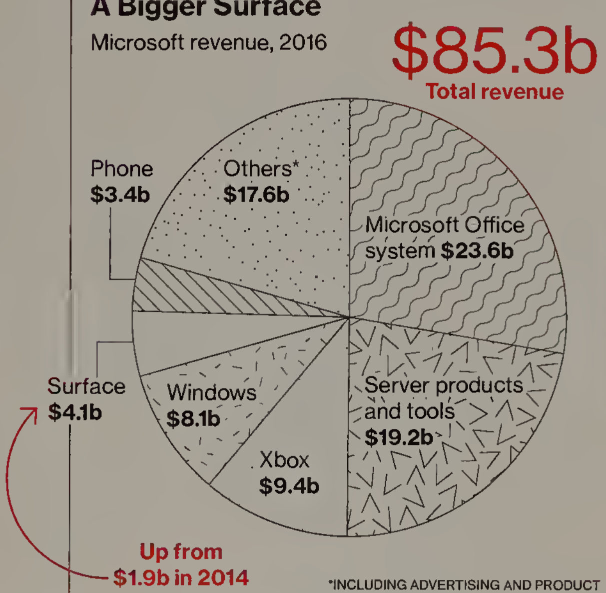
Microsoft has faltered here and there. It killed off a fitness-tracking wristband after releasing two pricey, lackluster, ill-fitting versions. The first high-end Surface Book laptop had too much space between the screen and keyboard when closed, prompting complaints that it let in dust and dirt. The quarterly revenue miss followed a slide in Surface tablet sales last year, according to researcher IDC, as Apple recaptured some share and Microsoft chose not to update the Surface Pro line last Christmas.

Still, Microsoft's hardware team is cautiously optimistic. The new products "are loved," Panay says. But "I say that to you humbly. Remember, I am also the person who went through the writedown. I am also the person who stood onstage and launched Surface RT."
—*Dina Bass and Mark Gurman*

The bottom line Nadella is trying to push Microsoft beyond safer hardware categories with a laptop aimed at the dusty MacBook Air.

A Bigger Surface

Microsoft revenue, 2016



*INCLUDING ADVERTISING AND PRODUCT SUPPORT SERVICES; DATA: BLOOMBERG

Steampunk

Google's Other Founder Wants to Fly, Too

▶ **Sergey Brin is quietly building a big ol' blimp in California**

▶ **Airships "could be actually more fuel-efficient than even a truck"**

Larry Page has his flying cars. Sergey Brin shall have an airship.

Brin, Page's **Google Inc.** co-founder, has secretly been building a massive airship inside Hangar 2 at the NASA Ames Research Center in Mountain View, Calif., according to people with knowledge of the project. It's unclear whether the craft, which looks like a zeppelin, is a hobby or something Brin hopes to turn into a business. "Sorry, I don't have anything to say about this topic right now," Brin wrote in an email. On April 28, Google parent **Alphabet Inc.** said in its annual proxy statement that it's leasing space to a Brin-affiliated company called **LTA Research & Exploration LLC.** (LTA is often used to stand for Lighter Than Air.)

The people familiar with the project say Brin has long had a fascination with airships, his interest spurred by visits to Ames, which is located next to Alphabet's headquarters. In the 1930s, Ames was home to the *USS Macon*, a huge airship built by the U.S. Navy. About three years ago, after ogling old photos of the *Macon*, Brin decided to build one of his own.

In 2015, Google subsidiary Planetary Ventures LLC took over the giant hangars at Ames from NASA and turned them into company labs. Brin's airship, which isn't an Alphabet project, is already taking shape: Engineers have constructed a metal skeleton for the craft that fills much of Hangar 2.

Alan Weston, Ames's 60-year-old former director of programs, is in charge, say the people familiar with the project. Weston, who didn't respond to requests for comment, has a background befitting such an enterprise. Born to Australian parents, he spent some of his youth in Turkey before attending the University of Oxford. There, he co-founded the Dangerous Sports Club, a group of highly intelligent risk-takers who did things like catapulting people across fields into nets.

As part of the club, Weston performed one of the first bungee jumps, hurling himself off California's Golden Gate Bridge, then eluding authorities waiting onshore to arrest him. He also hiked Mt. Kilimanjaro in Africa and attempted to hang-glide down, only to crash and hurt his ankle.

Years later, Weston joined the U.S. Air Force and did engineering work as part of the federal Strategic Defense Initiative, known as the Star Wars missile defense system. Following his stint at the Air Force, he joined NASA and worked on many projects, including a low-cost lunar lander. He left in 2013.

In a radio interview that year, Weston described plans for an airship that could be used to haul cargo. The idea he presented is that airships can be more fuel-efficient than planes and carry loads directly to where they're needed, rather than to transport centers such as airports or shipping stations.

"New airship technologies have the promise to reduce the cost of moving things per ton-mile by up to an order of magnitude," he said in the interview. "It depends on the size of the airship. A larger airship can reduce costs a lot more than a smaller ship, but there's design of a class of vehicles that can lift up to 500 tons that could be actually more fuel-efficient than even a truck."

Weston went on to describe an idea for a prototype of a helium-based craft that appeared to breathe. "The helium in the main envelope is taken and stored in bags inside the airship at a slightly higher pressure," he said. "As you do that, air is taken in from the outside into essentially like lungs that are attached in the side of the vehicle. So the analogy of breathing is a good one. And the overall lift of the vehicle is equal to the weight of the air that is being displaced by the helium. And as you change that, you can control the amount of buoyancy the vehicle has."

After being contacted about the airship, Weston changed his profile on LinkedIn to list his current job as chief executive officer of "Ltare." He then removed the profile.

There have been many attempts to build airships of this type in recent years. It's fitting for such a project to take place in Silicon Valley, which seems to have entered a steampunk phase, as people race to build flying cars and tiny reusable rockets. Brin's airship is separate from a lighter-than-air ship project called Calcifer that was shelved by Google X, the company's experimental research lab, in 2014.

Page, Alphabet's CEO, has funded at least two secretive flying-car startups, also separate from Alphabet. In April, **Kitty Hawk Corp.** released a video showing an electric vehicle taking off and soaring over a lake with the driver perched on top. —*Ashlee Vance*

The bottom line Brin has been working on airships for about three years in a NASA hangar, perhaps as a means of high-efficiency shipping.

Deals

Juno Got Sold, and Its Drivers Got Stiffed

▶ **The ride-hailing startup says drivers' stock options are void**

▶ **"Basically they did a bait and switch"**

When **Juno**, a new ride-hailing service, began recruiting Uber drivers in New York City early last year, it had a lot to offer. It took smaller commissions than **Uber Technologies Inc.** or **Lyft Inc.**, and it gave drivers the choice of about $100 in cash or the chance to accumulate stock. The equity, the company said, would give drivers the opportunity to share in the wealth if the business was successful. Juno said it was setting aside half the company's initial stock for its drivers.

As an Uber driver, Steven Savader felt mistreated and undervalued. So when he heard about the Juno deal, he signed up. "I wanted the shares," he says. "Driverless cars are going to come someday, and all the drivers were hoping that if the company gets big, we'd get a piece of the action."

"I wanted the shares. Driverless cars are going to come someday, and all the drivers were hoping that if the company gets big, we'd get a piece of the action." —*Steven Savader, Juno driver*

For a moment, it seemed like he and other drivers were in line for a windfall. **Gett Inc.**, a Tel Aviv-based ride-hailing company, announced on April 26 that it was buying Juno for $200 million. But that day, drivers received emails from Juno saying the stock ▶

◀ plan was void. For their shares to vest, they were required to drive regularly for Juno for two and a half years, and the company was only a year old when Gett bought it. They could instead receive cash payouts. The company told Savader his cut of the deal would be about $107, less than what he could make in a day of driving. "Basically they did a bait and switch," he says. "We all feel like we've been betrayed."

Juno often portrayed its equity plan as part of a deeply held philosophy. "We defined our core values, and we said it's all about respect, kindness, fairness, and transparency," Talmon Marco, the company's co-founder and chief executive officer, said during an interview in October. "When we make a decision, we always try to say, 'Hey, are we abiding by this sort of self-imposed constitution of values?'" Marco, who met with Savader and several other drivers last year to reassure them about the stock grants, didn't respond to interview requests. Gett referred questions to Juno, and a Juno spokeswoman declined to comment on the stock program, calling it "complicated." Gett told drivers it has no plans to offer equity as part of compensation.

Unvested stock units that disappear during acquisitions are a growing problem for employees of private companies, says Mary Russell, an attorney who advises startup employees on equity compensation. Until a few years ago, almost all stock compensation plans had clauses guaranteeing that unvested shares must be replaced with either equity in the acquiring company or cash equal to their value in the acquisition. But it's become increasingly common to include clauses allowing companies to cancel unvested shares, says Russell.

That seems to have been what happened in Juno's case. Several drivers showed Bloomberg the emails Juno sent them, offering cash payouts ranging from $100 to $251. Even if all of Juno's active drivers were given $250, the payouts would be worth about 1.5 percent of the company. Based on the offers to drivers viewed by Bloomberg, Juno valued each unvested share at 1.7¢.

Juno driver Ahmed Hashem, who also communicated directly with Marco last year, says he told the Juno CEO he felt Uber had abused him, and Marco assured him Juno would be different. "They promised to be better than Uber and everyone else," he says. "But they broke their promise." *—Joshua Brustein*

The bottom line Following its $200 million acquisition by Gett, Juno told drivers it was canceling their stock grants.

Digits

$5.5b

The new investment funding announced by Chinese ride-hailing leader Didi Chuxing on April 28, valuing the company at more than $50 billion

The extra money gives Didi a much better chance to expand outside China—and gives Uber Technologies one more thing to worry about

Of course, Uber also stands to benefit from Didi's success, since it owns about 17.5 percent of the Chinese company

Security

Seriously, Beware the 'Shadow Brokers'

▶ **The group's NSA-quality malware release isn't just another hack**

▶ **"This one's the big one, but now it just gets lost in the noise"**

It's not every day a trove of National Security Agency-quality hacking tools gets dumped on the open market, free for the taking, but that's what happened in April. Security researchers say there's evidence hackers have already used the tools to infect hundreds of thousands of computers around the world, installing a so-called backdoor that opens up the machines to an almost unlimited level of remote control.

So where's the panic? Compared with major vulnerabilities discovered in the past few years, such as the Heartbleed bug, which exposed weaknesses at companies including **Yahoo! Inc.** and **Amazon.com Inc.**, "it's 10 times worse," says Sean Dillon, a senior analyst at security company RiskSense Inc. who took apart the backdoor tool, called DoublePulsar, to study it. "The industry has cried wolf on naming all these vulnerabilities. This one's the big one, but now it just gets lost in the noise, like, 'Oh, it's this week's thing.'"

A hacking group known as Shadow Brokers posted the password for the encrypted cache in a bizarre, grammatically challenged message addressed to President Donald Trump on the social network Medium. The group went public last August, when it attempted to auction off a set of what are widely believed to be NSA hacking tools. (The agency has declined to comment.) The group apparently didn't get the response it wanted and instead made the whole lot public last month.

The tools, with names like EternalBlue and EternalRomance, worked on vulnerabilities in **Microsoft Corp.**'s Windows operating systems. Microsoft said in a statement that the problem was under control, more or less—most of the security holes had already been patched before the hacking cache went public. In the real world, of course, companies, particularly small ones, often run old systems, don't patch, and may not even be aware of the problem, meaning the Shadow Brokers tools remain effective.

Dillon figured out how DoublePulsar, perhaps the most

powerful tool, worked. It runs in kernel mode, the underbelly of an OS that's typically invisible to users and tough to code for, and, once opened, it gives hackers almost unlimited control over the system.

"It's the kind of thing you'd see used very rarely on very special, covert cybermissions," Dillon says. "This is like a jewel a government would guard, and now it's just spammed across the internet." He says he and his colleagues have found DoublePulsar in the computers of dozens of clients, including startups, government agencies, and at least one Fortune 100 company. "Every major malware family–botnets, spyware, banking malware–they're going to be incorporating this into their attacks."

BinaryEdge, a Swiss security company, says it found 428,827 DoublePulsar infections on April 27, up from 106,410 on April 21, by scanning computers connected to the internet. Dan Tentler, founder of security company Phobos Group, says about a third of the 4.5 million computers he's scanned remain vulnerable. "The reason we're seeing these numbers is there's no pressure on businesses to patch," he says. "People don't take this seriously until it bites them."

In the Medium post, Shadow Brokers claimed to be disappointed Trump supporters. Whatever the group's feelings about Washington, its cache is a huge gift to criminals, says Levi Gundert, vice president for intelligence and strategy at security company Recorded Future Inc. "The information that gets exposed has rarely been as relevant and valuable," Gundert says.

Recorded Future has been tracking message traffic about the tools on Russian hacking forums and Chinese-language websites. Three days after Shadow Brokers released the trove, a detailed tutorial on how to use EternalBlue and DoublePulsar was already circulating on a top-tier hacking forum. "The impact of this will be felt for years," Gundert says. "If you look at some of the worms that were around in 2007, 2008, 2009, they're still around." *—Dune Lawrence*

The bottom line The hacking tools released by Shadow Brokers may have infected more than 400,000 computers and could be tough to erase.

Edited by Jeff Muskus
Bloomberg.com

Innovation

Robotic Patio Umbrella

Form and function
ShadeCraft's Sunflower uses motors and sensors to unfurl itself and track the sun. It's also solar-powered and has built-in Bluetooth speakers and two security cameras that users interact with through an app.

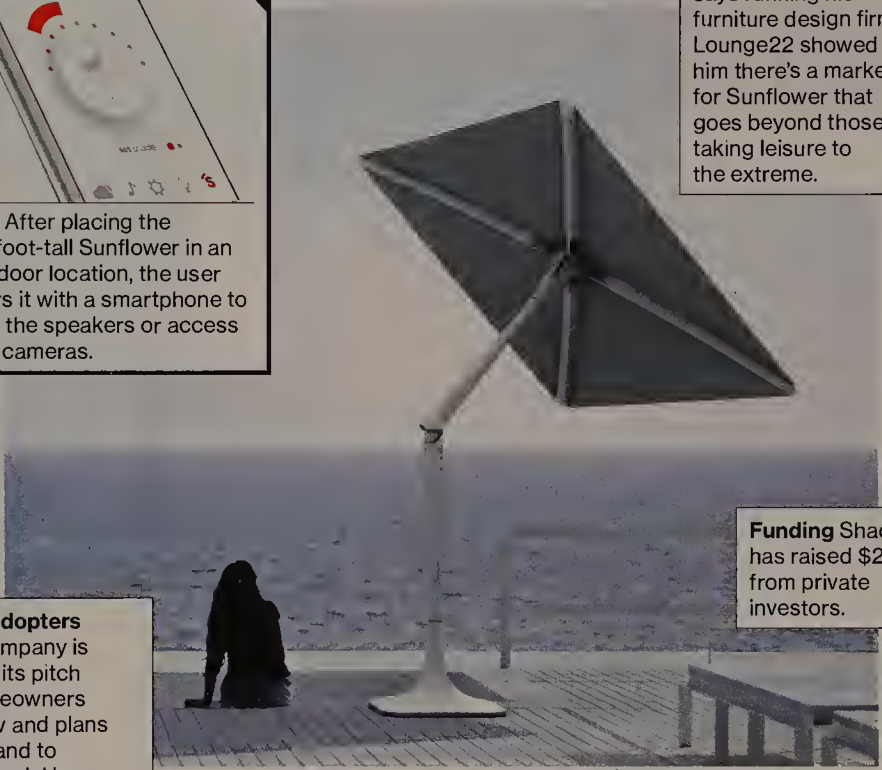
Innovator Armen Gharabegian

Age 48

Chief executive officer of ShadeCraft, an 11-employee startup in Pasadena, Calif.

1.

Set After placing the 10-foot-tall Sunflower in an outdoor location, the user pairs it with a smartphone to use the speakers or access the cameras.



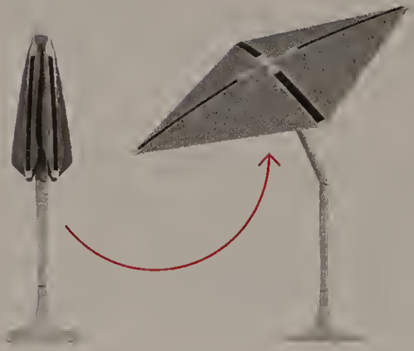
Origin Gharabegian, an industrial designer by training, says running his furniture design firm Lounge22 showed him there's a market for Sunflower that goes beyond those taking leisure to the extreme.

Funding ShadeCraft has raised $2 million from private investors.

Early adopters The company is aiming its pitch at homeowners for now and plans to expand to commercial buyers such as hotels.

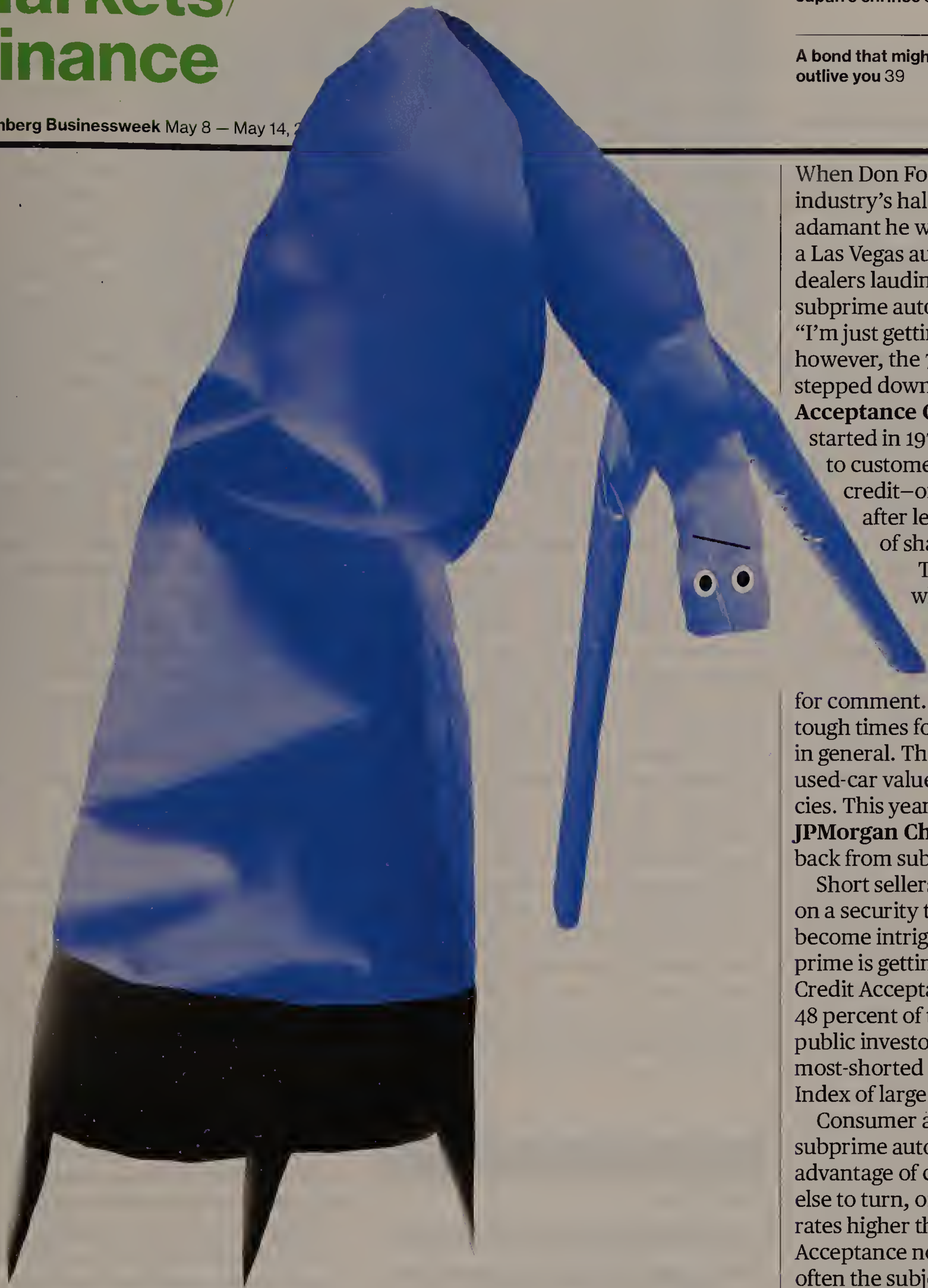
2.

Forget With the help of its sensors, the 7-square-foot umbrella unfurls itself in sunny weather and folds up to avoid wind damage. Three electric motors allow it to rotate 360 degrees and tilt up to 45 degrees as the sun moves.



Next Steps

Aseem Prakash, co-founder of the Center for Innovating the Future, a consulting firm in Toronto, says ShadeCraft's beta umbrella is one of the most successful integrations of robotics and design he's seen in the consumer market. Gharabegian says he'll start taking orders for the Sunflower this summer at about $2,700 apiece, and the umbrellas will begin shipping early next year. *—Michael Belfiore*



E-Z Auto Loans Are A Tough Business

▶ Skeptics think a subprime star could be vulnerable

▶ "The whole genius of this company is the risk-sharing program"

When Don Foss was inducted into his industry's hall of fame in 2015, he was adamant he wasn't retiring. Addressing a Las Vegas audience of used-car dealers lauding him for creating the subprime auto-loan business, he said, "I'm just getting started." In January, however, the 72-year-old billionaire stepped down as chairman of **Credit Acceptance Corp.**, the company he started in 1972 that extends auto loans to customers with rock-bottom credit—or none at all. A month after leaving, he sold a big chunk of shares for $128 million.

The company didn't say why Foss sold his shares and declined to comment for this story. Foss didn't respond to requests for comment. His exit coincides with tough times for subprime auto lenders in general. The industry faces declining used-car values and higher delinquencies. This year, **Wells Fargo & Co.** and **JPMorgan Chase & Co.** have pulled back from subprime loans.

Short sellers—investors who bet on a security to fall in price—have become intrigued by the idea that subprime is getting risky. Bearish bets on Credit Acceptance have risen to about 48 percent of the shares tradeable by public investors, making it the third-most-shorted stock on the Russell 1000 Index of large and midsize companies.

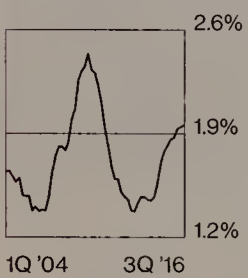
Consumer advocates say the subprime auto-lending industry takes advantage of consumers with nowhere else to turn, often charging interest rates higher than 20 percent. Credit Acceptance notes in its filings that it's often the subject of consumer lawsuits and regulatory investigations over its loan-making and collection practices. Claims of predatory practices have dogged the industry for decades. Credit Acceptance typically counters that it abides by the terms of the contracts signed by its customers. In February, it disclosed that the Federal Trade Commission was investigating its use of devices that disable vehicles remotely when payments are missed. It said it was cooperating with the inquiry.

Investors looked past such questions. Credit Acceptance's share price more ▶

◀ than doubled over the past five years. But now some worry a shift in its business makes its price hard to justify. After profiting handsomely from a strategy that shares loan risk with dealers, Credit Acceptance is lending more on its own, increasing its exposure to defaults. "The shift is unhealthy," says Ben Weinger, portfolio manager at hedge fund 3-Sigma Value, which has bet against Credit Acceptance shares. "The whole genius of this company is the risk-sharing program."

Subprime Auto Loans

New-delinquency rate*



The son of a used-car salesman, Foss opened his first lot in 1967. He founded Southfield, Mich.-based Credit Acceptance to handle financing and collections for his dealerships, then expanded to working with other dealers. Foss introduced the risk-sharing system, called the portfolio program, in the late 1980s.

In the portfolio program, when a cash-strapped customer wants to buy a car, Credit Acceptance will advance the dealer about 40 percent of the total value of the loan, typically enough to cover the cost of the car to the dealer plus a small profit. Once that part has been paid, Credit Acceptance shares any remaining payments with the dealer. The company is shielded from much of the credit risk, because its advance is secured by the car. It can repossess the wheels while pursuing the defaulting customer in court.

"It was a growth juggernaut," recalls Richard Beckman, who was president of Credit Acceptance in the 1990s. Foss has a $1.3 billion fortune, according to the Bloomberg Billionaires Index, and he's still the largest shareholder in the company, with a $700 million stake.

The program's success attracted competitors, making it harder for Credit Acceptance to draw in dealers. So in 2005, three years after Foss stepped down as chief executive officer but while he was still chairman, the company added another program. Under the so-called purchase program, Credit Acceptance started to buy some loans outright. Dealers got more money upfront, while the company kept all the payments. A quarter of Credit Acceptance's $4.5 billion loan book consists of purchase loans, up from 16 percent at the end of 2015. Credit Acceptance expects to collect 65 percent from loans it has made so far this year, according to filings. That's lower than its recovery rates over the past two decades but better than those reported by its peers.

Credit Acceptance has said in filings that the purchase loans have been profitable since they were introduced. Yet it concedes the change isn't welcome. "We recognize that if collections fall short of our forecast, the impact on profitability will be much greater with purchase loans than with portfolio loans," CEO Brett Roberts wrote in his letter to shareholders in April.

Steve Eisman, made famous in Michael Lewis's book *The Big Short* for his bet on the mortgage crash, said in March he was concerned about subprime auto loans. Some supporters of Credit Acceptance say it's being targeted by short sellers looking to get on a bandwagon and that the company's experience will enable it to ride out any downturn as competitors exit. Randy Heck, a general partner at Goodnow Investment Group, who's owned shares in Credit Acceptance for 19 years, says "everyone wants to play this theme of the auto-lender bubble, but Credit Acceptance is the absolute wrong vehicle for this." *—Tom Metcalf*

The bottom line Credit Acceptance thrived by sharing the risk of loans with car dealers, but that's gotten harder to do.

Real Estate

Japan's Priests Turn to Property Development

▶ **Shrines are costly to maintain, and they occupy prime land**

▶ **"They need side businesses to make ends meet"**

Shinto elders at the centuries-old Unesco World Heritage Site of Shimogamo Shrine upset some neighbors when they bulldozed a swath of old Kyoto forest to build an apartment complex with units selling for more than $2 million apiece. "They should call it the Shimogamo Corporation," says one angry parishioner, Akira Hitomi.

Skepticism of religion is common enough in Japan that there's a saying, "If you want to get rich, become a priest." In truth, many of Japan's 180,000 temples and shrines are in deep financial trouble, says Yoshihide Sakurai, a professor of sociology of religion at Hokkaido University. "They need side businesses to make ends meet." Many people in Japan visit Shinto shrines for weddings and New Year's Day, and Buddhist temples for funerals, but fewer than 40 percent consider themselves religious, according to surveys by public broadcaster NHK. Fewer still are devoted enough to pay for the upkeep of places of worship, many of which are hundreds of years old and made of wood.

To make money, Japanese priests have hosted speed-dating events, rapping battles, and televised flower-arranging contests. They've also turned to real estate, a sign of the times as Japan experiences a property boom fueled by ultralow interest rates and a new inheritance tax that's encouraged retirees to shelter money in rental properties. Real estate investment last year accounted for about a third of the country's economic growth.

Location, location, location–it's the big reason consultants and developers, including **West Japan Railway Co.** and homebuilding giant **Sekisui House Ltd.**, are pitching projects to priests. Temples and shrines occupy some of the best buildable spaces in the country's jampacked cities. In the central district of Osaka, wrecking balls are busy demolishing an old building Otani Shinshu Buddhists used for weddings and funerals. When construction is finished in 2019, a 17-floor business hotel operated by the **Excel Tokyu Hotel** group will stand beside the temple's main hall. In Tokyo, **Mitsui Fudosan Co.** has so far developed an office tower and two condominiums on land leased from shrines. One is a short walk from the country's busiest train station.

At Nashinoki Shrine, a 100-year-old Shinto complex right outside the walls of Kyoto's imperial palace, priests in 2012 leased away the only open space they had. Now the shrine's approach snakes around the back of a three-story

Many shrines are in bustling city locations

apartment building sandwiched between two towering entry gates. "It's not a good look," says Mieko Okajima, a tourist from Tokyo stopping by to drink from the shrine's spring. Nodding to a sign inviting visitors to fill their water bottles for a $2 donation, she says: "It used to be free." A priest ambling by is unapologetic—he says he'd be glad to hear other ideas to keep things going.

Even in Kyoto, where zoning regulations are among the strictest in Japan, no laws prevent temples or shrines from building on their grounds. "As long as they don't violate construction codes, we can't stop them," says Tomoko Uehara, head of Kyoto's historical preservation division.

For priests who feel uncomfortable with development that's too nakedly commercial, builder Sekisui House may have a solution: "pilgrimage lodgings." Visitors have long been able to get a taste of the monastic lifestyle by paying the equivalent of a few dollars and volunteering to help with chores in exchange for a night in a bare-bones temple dormitory. This is not that, explains Sekisui spokesman Masayoshi Kusunoki. "It's basically a business hotel, but with a traditional Japanese aesthetic," he says.

Sekisui's temple hotels, which the company started marketing in April, will be manufactured in blocks on a factory line and can be snapped together on-site. The **Hyatt Regency** hotel chain has started an upscale version of the idea at five temple locations in Kyoto. A night at one of its bungalows starts at about $1,500 per person. No meditation required.

Shimogamo Shrine began its adventures in real estate to get out of a financial pinch, says Hideaki Seo, a planner at the development arm of West Japan Railway, which managed the shrine's project. For seven centuries, Shimogamo Shrine has performed a radical—and costly—ritual of spiritual renewal, ripping down and rebuilding its giant wooden structures every 21 years. In 2013, the shrine could raise only half the $30 million needed.

That's when the elders began to look to development, and some parishioners started to protest. Hitomi, a property broker himself, says he gathered signatures from more than 8,000 other residents who wanted development stopped, but to no avail. He's surprised that Shimogamo's priests, who pack in weddings every 30 minutes on weekends, say they're broke. Representatives of the shrine declined to comment.

Once construction is finished in June, visitors to Shimogamo Shrine will enter by a path that runs down the middle of a well-landscaped apartment complex. Two-thirds of the 99 units are already under contract. The average price per square foot rivals some of Tokyo's most expensive neighborhoods. —*Jason Clenfield and Katsuyo Kuwako, with Pavel Alpeyev*

The bottom line In Japan's packed cities, shrines and temples control real estate that hotel and apartment developers covet.

Debt

Mnuchin Ponders Locking in Low Rates

- **The Treasury just might offer a 50-year bond**
- **"Demand for ultralong issuance will not be robust enough"**

U.S. Secretary of the Treasury Steven Mnuchin first hinted in November that the Trump administration would entertain the idea of selling ultralong Treasuries—bonds that wouldn't mature for perhaps 50 years. The consensus across Wall Street was pretty clear: Don't do it. There would be no easy way to lure a steady stream of buyers, the skeptics said, and the bonds might not be as good a deal for U.S. taxpayers as they seem.

But it looks as if Mnuchin has other ideas. He recently had his staff query bond dealers and the Treasury Borrowing Advisory Committee, a group of representatives from major banks and investment funds, about how to structure and price bonds with maturities beyond the current 30-year limit. And on May 1 he told Bloomberg TV that such a bond "could absolutely make sense."

It isn't hard to understand the attraction of longer maturities. The interest rates investors demand for lending the government money are still historically low, a bit less than 3 percent a year for 30-year Treasury bonds as of May 3. The argument is that the U.S. "won't have to pay much to gain more certainty and the ability to lock in low rates for a long time," says Scott Mather, chief investment officer for U.S. core strategies at Pacific Investment Management Co.

The Treasury seems "committed to the idea that we are going to issue debt that is greater than 30 years," says Jim Bianco, Chicago-based founder of Bianco Research LLC, who's been following the U.S. bond market for almost four decades. "It's a change in the calculus from the previous administration."

Very long bonds aren't without precedent. In 1911 the U.S. sold 50-year bonds to fund the Panama Canal, then the most expensive construction project in U.S. history. Gary Cohn, Trump's top economic adviser, spoke in an interview on CNBC about the "enormous amount" of ultralong bonds the government could issue to finance spending on infrastructure.

Several Democrats are on board with the idea as well. Last year, Mark Warner, the ranking Democratic member of the Securities, Insurance, and Investment subcommittee of the Senate Banking Committee, pushed then-Treasury counselor Antonio Weiss on why the U.S. wasn't selling ultralongs. Warner hasn't changed his tune. "If there is an appetite for long-term debt in foreign markets and with U.S. corporations and universities, there would ▶

Malls A New Use For Empty Spaces

Malls are fighting for shoppers with one thing their web rivals can't offer: parking lots. With customer traffic sagging, U.S. retail landlords are using their sprawling concrete fields to host carnivals, concerts, and food truck festivals. —*Heather Perlberg*

Marley Station Mall in Maryland

Events bring "additional traffic and also encourage people to stick around longer." —*Lisa Harper, senior director for specialty leasing at CBL & Associates Properties Inc.*

$60k
The amount a large event can generate for a landlord in a week, says event producer KevaWorks Inc.

20%
Decline in shares of publicly traded mall landlords in the past year

◀ be sufficient appetite to market the debt of the world's safe haven and reserve currency," Warner said in an emailed reply to questions.

For the naysayers, a key question about ultralong bonds is who's buying them. The Treasury cares a lot about maintaining regular and predictable auctions of fresh bonds. It's one reason the U.S. bond market has become the deepest and most important in the world. But finding enough demand to issue 50-year bonds on a regular basis could be challenging. For most investors, a 50-year bond would be a risky bet. Although it would be all but certain to be paid back in full, the market value prior to maturity of all bonds swings as investors change their assumptions about the path of interest rates and inflation. The longer the maturity, the wider the swings.

The most likely buyers would be institutions such as insurers and pension funds, which have very long-term obligations and want bonds with maturities to match them. To attract investors, the Treasury will probably have to pay premiums on interest rates. A 50-year bond would likely yield about 0.2 percentage points more than 30-year Treasuries, according to JPMorgan Chase & Co., whose analysts said such sales aren't a good idea.

David Mericle, an economist at Goldman Sachs Group Inc., said in a report that he doesn't expect the Treasury to sell ultralong-term debt partly because it's "likely to again receive skeptical feedback" from the Wall Street banks that act as dealers in the bond market. Morgan Stanley warned in an April 21 report that "investor demand for ultralong issuance will not be robust enough."

Such criticisms have become more muted recently. While a number of dealers, ex-Treasury officials, and former members of the advisory committee still voice concerns, few will do so publicly. But according to documents released by the Treasury on May 3, the advisory group didn't see evidence of "strong or sustainable" demand.

Whatever the case, big Treasury decisions are often political decisions. Under Larry Summers, Bill Clinton's Treasury secretary, the department in 1997 introduced inflation-linked bonds, known as Treasury Inflation-Protected Securities, or TIPS. The idea was to provide policymakers a market-based gauge of inflation expectations. Some studies have shown they ended up costing billions of dollars in extra interest. Former Treasury Undersecretary Peter Fisher ended sales of the 30-year bond in 2001, only to see it revived in 2006 as the war in Iraq and the Bush administration's tax cuts caused record budget deficits.

Several other countries have issued ultralong bonds in recent years to take advantage of low rates. Canada, France, Mexico, Switzerland, and the

U.K. have sold debt maturing from 40 years to 100 years, though few have done so on a regular basis. Several companies have issued century bonds.

Fisher, who's now a senior lecturer at Dartmouth, says a good argument for the U.S. government to consider issuing ultralong bonds is that they wouldn't come due and need to be rolled over during the years when droves of baby boomers retire and draw Social Security. "I had hoped to come back and eventually issue 60- or 100-year maturities, but we didn't get around to it," he says, referring to his tenure at the Treasury.

Gemma Wright-Casparius, a senior portfolio manager at Vanguard Group Inc., says one feasible approach would be for the Treasury to cut the size of its 30-year bond sales to make room for a 50-year bond. She says Vanguard, which oversees $4.1 trillion, would be a buyer if the ultralongs were included in benchmark bond indexes—as long as the price is right. "I don't see any reason why not," she says. "For Treasury, anything is possible, as long as they do their due diligence." —*Liz Capo McCormick and Saleha Mohsin*

The bottom line Wall Street is skeptical about the demand for an ultralong bond, but the U.S. Treasury seems interested in selling one.

Mortgages

Canadian Finance Gets Less Boring. That's Bad

- **Trouble at a small housing lender raises questions about the boom**
- **"We could see credit tightening really quick"**

A group of Canadian real estate professionals out to relax in Mexico in late April kept an eye on the news about **Home Capital Group Inc.**, a small mortgage lender back home. "Home Capital was on everybody's lips," says Jason Georgopoulus, a mortgage broker with Dominion Lending Centres Inc. in Toronto. In between margaritas and rounds of golf at an industry retreat in Los Cabos, he saw Home Capital's share price plunge and its debt rating cut to junk status. "People were surprised because a lot of them have had a very positive relationship with the company over the last 30 years," he says.

Home Capital is what's known in Canada as an alternative mortgage lender, specializing in loans to people who might not be able to get financing from big banks. On April 19, the Ontario Securities Commission accused it of misleading investors by not informing them about some fraudulent loans that were brought in to the company by outside brokers. Home Capital has vowed to "vigorously" defend itself against the allegations. Its stock price has fallen by two-thirds since then, and its customers have withdrawn C$1.6 billion ($1.17 billion) of their deposits.

The delinquency rate on Home Capital mortgages was just 0.2 percent as of February. Still, the company's troubles come at a time when Canadians are increasingly worried about frothy housing prices. Toronto prices were about 25 percent higher in April than a year earlier. Price gains have spread to other Ontario cities including Windsor and Niagara Falls.

"Canada's reputation as a boring-but-stable financial system took a bit of a hit this week," wrote Alex Bellefleur, head of global macro strategy and research at Pavilion Global Markets Ltd. in Montreal, in a note to clients on April 28. He predicts lending will slow across the industry, hurting home prices and delaying new construction.

Home Capital accounts for just 1 percent of the mortgage market in Canada. The worry is about contagion—investors and depositors pulling away from other mortgage lenders. To head off such concerns, lender **Equitable Group Inc.** told investors it had set up a credit line with a group of five banks. If mortgage providers become more anxious about contagion risks, they could scale back lending. Alternative loans make up almost 13 percent of the market. "We could see credit tightening really quick," says Bruce Joseph, principal broker at Barrie, Ontario-based Anthem Mortgage Group.

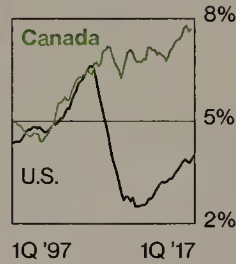
As it looks for possible buyers, Home Capital has begun drawing on a C$2 billion emergency loan at an effective rate of 22.5 percent. The loan made Jim Hall, chief investment officer at Mawer Investment Management Ltd., rethink the odds of the company's problems rippling into the wider economy. "The probability has gone from infinitesimal to possible—unlikely, but possible," said Hall in an April 29 interview.

Canada largely avoided the financial meltdown that swept the U.S. in 2008, thanks in part to a conservative banking culture. The country's investment in residential housing has remained high, at more than 7 percent of gross domestic product, compared with less than 4 percent south of the border. The continued availability of credit has aided the boom, and the Bank of Canada in its latest financial system review noted that borrowers are increasingly making smaller down payments.

High prices have made Vancouver and Toronto increasingly unaffordable, and provincial governments have been taking measures to cool things off. On April 20, Ontario Minister of Finance Charles Sousa announced a 15 percent tax on purchases by foreign buyers as well as expanded rent controls.

Residential Investment

Share of GDP



It could take a while to see whether those moves, or Home Capital's problems, are having a real effect on prices. "What actually happens in housing markets is that prices don't change that fast, but the activity changes," says Andrew Moor, chief executive officer of Equitable Group Inc. "People hold up their house looking for that price—then buyers don't think it's worth it, things slow down, and then eventually the prices correct." Toronto sales fell in April from a year earlier.

Ara Mamourian, owner of Toronto real estate brokerage Spring Realty Inc., doesn't expect Home Capital to weigh on home prices. "I don't think clients really know what's going on for them to be concerned enough," he says. "After a couple of quarters this will all blow over." —*Kim Chipman*

The bottom line Home Capital owns just a sliver of Canada's mortgages, but its problems have struck a nerve in a time of fast-rising home prices.

Edited by Pat Regnier
Bloomberg.com

AMAZO
KNOW WH

After years of futility, Wal-Mart has an expensive new plan to win at e-commerce

Wal-Mart CEO Doug McMillon and Jet.com founder Marc Lore

WON'T
AT HIT 'EM!

By
Brad Stone

and
Matthew
Boyle

Photograph
by Meredith Jenks

Last summer, Marc Lore, founder and chief executive officer of e-commerce startup Jet.com Inc., sat down to record a private video for the top officials of the world's largest retailer: Wal-Mart. In the video, meant for Wal-Mart executives and board members who weren't yet part of weeks of secret negotiations between the companies, Lore stares earnestly into the camera and shows off his Bentonville bona fides. After humblebragging about reading every annual report since 1972, he says he's been "struck by Wal-Mart's maniacal focus" over its storied 54-year history.

But Lore's 40-minute presentation doesn't hold back about the threat posed by its most fearsome and increasingly powerful archrival. "AMAZON IS DOMINATING" reads a slide on a large screen behind him. In the video, Lore presents a plan to bet Wal-Mart's future not on e-commerce standbys such as books, electronics, and toys, but on product areas only now becoming popular online, including apparel, fresh food, and "everyday essentials" like drugstore items. "We'll need to take the offensive, swim upstream," Lore says. "As Sam Walton said, 'Opportunity lies in the opposite direction.'"

The video worked exceedingly well. In August, Wal-Mart Stores Inc. announced it would acquire Jet.com for $3.3 billion in cash and stock. It was an extraordinary sum for a 15-month-old, purple-hued website that was struggling to retain customers and is still far from making a profit. Even more astonishing, Lore and his management team in Hoboken, N.J., were put in charge of Wal-Mart's entire domestic e-commerce operation, overseeing more than 15,000 employees in Silicon Valley, Boston, Omaha, and its home office in Arkansas. They were assigned perhaps the most urgent rescue mission in business today: Repurpose Wal-Mart's historically underachieving internet operation to compete in the age of Amazon. "Amazon has run away with it, and Wal-Mart has not executed well," says Scot Wingo, chief executive officer of Channel Advisor Corp., which advises brands and merchants on how to sell online. "That's what Marc Lore has inherited."

Lore's ascendancy at Wal-Mart adds bitter personal drama that wouldn't seem out of place on *Real Housewives of New Jersey* to a battle between two of the most disruptive forces in the history of retail. In 2010, Wal-Mart tried to buy Lore's first online retail company, Quidsi Inc., which operated websites such as Diapers.com for parents and Wag.com for pet owners. But it moved too slowly and lost out to a higher bid from Amazon.com Inc. Lore then toiled at Amazon for a year and a half before quitting, in part out of disappointment with its refusal to invest more in Quidsi and to integrate his team into the company, according to two people close to him.

"The Jet.com deal is a big inflection point," says a former Wal-Mart executive. "This is Wal-Mart's last shot here"

Jet, which he started a year after leaving Amazon, sells almost everything—books, electronics, clothes—so it was difficult to miss an element of revenge among his motivations. Jeff Bezos, Amazon's CEO, certainly noticed. In case anyone underestimated the enmity coursing through the Lore-Bezos feud, Amazon announced in March that it was closing Quidsi, saying it didn't see a path to profitability. Coming from the historically money-losing internet giant from Seattle, the pointed wording of the announcement was widely interpreted as an effort to undermine Lore's credibility at Wal-Mart.

Lore cuts an unusual figure at the Bentonville headquarters, which he now visits once a month on a private company plane, and in the geeky hallways of San Bruno and Sunnyvale, Calif., where most of Walmart.com's engineers work. He's a former bank risk manager and longtime New Jersey resident who's a fan of Bruce Springsteen and of figuring out ways to simplify the routines of daily life. He recently ditched his Tesla and uses only Uber, for example, and he visits the same sushi restaurant near his office four times a week, always ordering the salmon sashimi. He also spends time on customer-pleasing contrivances that, in the parlance of Silicon Valley, do not scale. He recently devoted a 12-hour day to recording a thousand variations of a video greeting for new Jet customers. Now when customers sign up, Lore welcomes them by their first name.

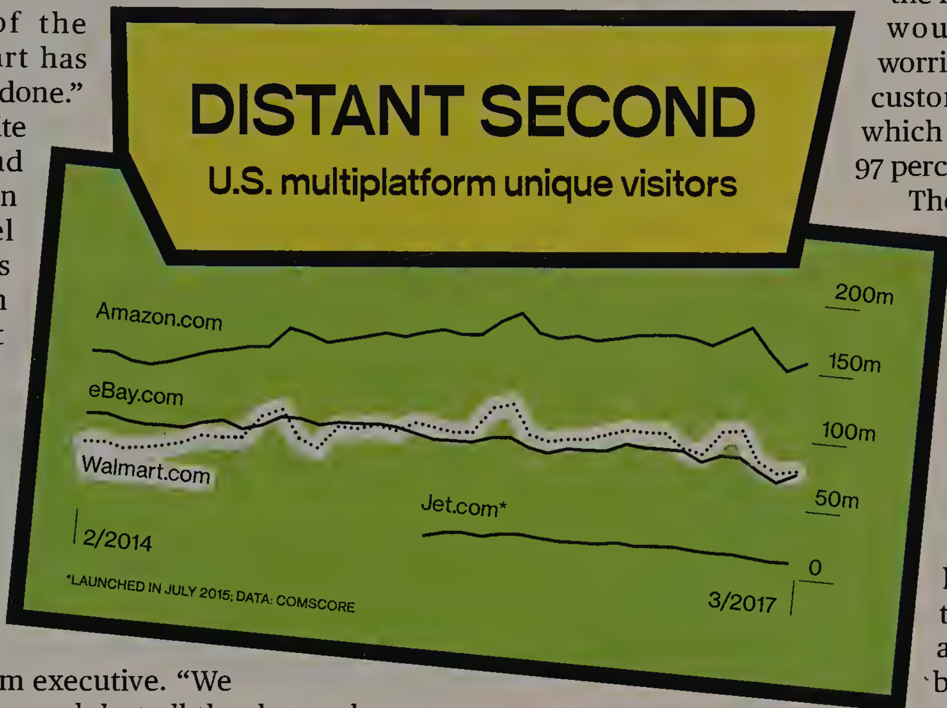
He'd like to extend Jet's sensibility and business model to Walmart.com, the second-biggest e-commerce destination in the U.S., according to ComScore Inc. A site redesign is due this summer. (He's thinking of recording another set of personalized introductions.) Lore also recently announced free delivery on Walmart.com for orders of more than $35, a Jet-like (and Amazon-like) tactic to give customers discounts for buying more stuff at once, so it can be shipped more efficiently in a single box. He also announced that shoppers will be able to save money on 1 million products if they order online and pick them up at one of the chain's 4,700 U.S. stores, where it's cheaper for the company to deliver.

Crowning the entire strategy is an acquisition spree: buying middling e-commerce startups such as Shoebuy.com ($70 million), fashion retailer ModCloth ($75 million), and outdoor apparel seller Moosejaw ($51 million); installing their founders as his deputies; and selling their products on Walmart.com, where the selection still lags far behind Amazon's. Later this spring, Lore is also likely to announce Wal-Mart's reported $300 million acquisition of Bonobos Inc., a decade-old menswear website that offers well-fitting pants and a team of enthusiastic customer service people—Bonobos calls them "ninjas"—that wouldn't normally be associated with a giant like Wal-Mart.

Wal-Mart has a lot riding on Lore. Last year he received $244 million in pay, 10 times that of his boss, Doug McMillon, Wal-Mart's CEO. His project could determine the future of Sam Walton's legacy and the eventual success of McMillon. It will also settle the score on whether Lore is good at building profitable e-commerce sites or just selling unprofitable ones to his competitors for piles of money.

"Marc's been given quite a bit of freedom to go get it done," McMillon says.

Since the beginning of the e-commerce era, Wal-Mart has repeatedly failed to "get it done." In 2000 it spun out its website as a separate company and raised capital from the Silicon Valley venture firm Accel Partners. Eighteen months later, after the dot-com crash, Wal-Mart bought the operation back for an undisclosed sum. The move didn't accomplish much of anything: Sales were disappointing—$25 million in 2000, with $100 million in clothes and other inventory left over after the holidays, according to a former senior Walmart.com executive. "We had built fulfillment for apparel, but all the demand came from electronics," he says.



The company considered buying Gap Inc. and even Netflix Inc., the former executive says. But the decision-makers in Bentonville, intoxicated by the narcotic of constructing profitable superstores, underestimated the sublime convenience of shopping from the home or office. Many Walmart.com managers reported to Wal-Mart's chief financial officer or vice chairman instead of the CEO, and they were pressured to show profitability. Over in Seattle, Bezos was building Amazon to gobble up market share, not generate earnings for investors.

Wal-Mart showed flashes of commitment to the internet later in the decade, engaging in a holiday price war on media products with Amazon in 2009 and making its unsuccessful run at Quidsi in 2010. But the next year, then-CEO Mike Duke spent $300 million to acquire a search engine, Kosmix, run by two former Amazon executives, who then created a Silicon Valley skunkworks called @WalmartLabs. They left after a year, partly in frustration over Wal-Mart's bureaucracy.

In 2012, with Amazon's stock booming—up 45 percent that year—Duke hired Neil Ashe, the former chief executive of the online news network CNet, to run Wal-Mart's global internet operation. Ashe, who had no previous retailing experience, reported directly to Duke and was given a mandate to deepen Wal-Mart's digital investments. He and his team made some progress. They rebuilt the badly outdated technology infrastructure underlying Walmart.com, introduced smartphone apps, and constructed six fulfillment complexes outfitted with state-of-the-art automation. The company's U.S. e-commerce revenue went from an estimated $4.54 billion in 2012 to $8.03 billion in 2016, according to an analysis by Wells Fargo & Co.

It was a start. But though Amazon loomed large, Wal-Mart's most significant fights were internal. One perennial source of tension involved prices. Amazon typically sets them using algorithms that scour the web to monitor and match the lowest number they find, which means prices can change constantly on the site. Wal-Mart sets a consistent "everyday low price" inside its stores. It's one of the most sacrosanct brand promises in retail, practically inscribed onto holy tablets by Walton himself as a way to assure customers they won't have to comparison-shop. The philosophy created problems on the web, though. Whenever the online price dropped below the in-store price, the merchants in Bentonville would balk. They were worried about siphoning away customers from their stores, which account for more than 97 percent of Wal-Mart's sales.

The company was also hesitant to let outside sellers list their wares on Walmart.com. This "marketplace" idea generates half of Amazon's unit sales. It also creates a prodigious amount of unseen internal conflict, since Amazon employees have to compete with third-party sellers who are pursuing the same buyers. But the company tolerates and even encourages the tension because choice and price competition are good for customers. Wal-Mart, accustomed to dominating its relationship with brands and showing its entire assortment in its massive stores, was reluctant to foster such competition, and it didn't have the technological chops to support an expansive marketplace. Instead of focusing on increasing online selection, Wal-Mart kept building supercenters—more than 700 from 2010 to 2016 in the U.S. alone. Walmart.com only started adding third-party sellers in 2015, and though it now has more than 40 million products in its marketplace—Toms canvas shoes, Rebecca Minkoff satchels, and other stuff it doesn't sell in stores—the number is small compared with the 350 million or so items available on Amazon.

When McMillon, now 50, took over as CEO in late 2014, things began to change. He's a sandy-haired former high school point guard who famously started at Wal-Mart as a teenager, working summers in an Arkansas stockroom. He's also the company's first CEO since the founder young enough to have high school-age children. McMillon has gradually come to shed the customary Wal-Mart suit and tie in favor of casual sport coats and open-collar shirts, and plays up the notion that he's a "bit of a gadget guy." He once bought a Kindle for his mother, and regularly invites tech luminaries such as Facebook Inc.'s Sheryl Sandberg to senior staff meetings. "I want us to sell VR before the customer is ready for it," he says. "I keep telling our folks, 'Buy a little and put it online, put it in 50 stores.' Don't tell me it won't sell unless you try it. You gotta catch the wave. And to catch the wave, you gotta be early."

Over the past few years, Wal-Mart has notched decent numbers, including 10 consecutive quarters of same-store sales growth in the U.S. and 1 percent to 2 percent increases in revenue

Recent Acquisitions

$3.3b
JET.COM
Discount e-tailer

$300m*
BONOBOS
Men's fashion retailer

$75m
MODCLOTH
Women's fashion retailer

$70m
SHOEBUY.COM
Footwear e-tailer

$51m
MOOSEJAW
Outdoor apparel seller

each year. Over the holidays, its online unit recorded 29 percent sales growth over the previous year. But Amazon has been enjoying 20 percent-plus annual sales growth, and many experts say the e-commerce market could double in the next decade. The company already dominates the cities and coasts, and its next stop is the heartland, home to Wal-Mart's customer base.

McMillon has attempted to adjust to the shifting retail landscape. He's closed about 175 stores, reduced the size of others, and boosted pay to full- and part-time workers. He also paid a price that most analysts thought was exorbitant, if necessary, to send a clear message to everyone inside Wal-Mart about the urgency of the online effort. "The Jet.com deal is a big inflection point," says Venky Harinarayan, one of the Kosmix founders and a former @WalmartLabs director. "This is Wal-Mart's last shot here."

Several analysts share the sentiment. "Doug realized there needed to be some radical changes made, as Wal-Mart was rapidly going in the direction of close-to-defunct retailers," says Karen Short, who studies the stock for Barclays PLC. "There was a realization that you have one shot to get that customer back in the door, so you better make sure you get it right." Sanford C. Bernstein & Co. analyst Brandon Fletcher is reading from the same script: "This is their last window to get it right," he says.

Perhaps the same could be said of Lore. In the fall of 2015 he was seeking Jet's fifth round of funding. The startup had already spent almost $200 million in venture capital setting up its website and blanketing cities with mailings and outdoor ads. A year after the site's launch, critical media reports suggested Jet wasn't gaining traction with customers, framing the company as an example of Silicon Valley profligacy. The accounts weren't altogether off-base; according to Second Measure, a company that analyzes credit card data, among a sample of 8,000 customers who joined Jet.com that October, fewer than 400 were still buying from the site six months later.

Publicly, Lore played it cool. Privately, he was a wreck. He says he pulled two straight all-nighters while he was closing the round. He was so exhausted on one red-eye flight, he vomited all over his coach-class airplane seat. He eventually succeeded, though, raising $500 million, at a $1 billion valuation, from Fidelity International, Bain Capital, Google Ventures, and Alibaba Group Holding. "That round was definitely stressful," he says. "We had less than four weeks of cash left in the bank when we finally closed it."

Lore was making the same risky bet that Bezos had years before. E-commerce businesses that start out looking frail can generate healthy amounts of cash if they make it past infancy. And though it wasn't working yet, Lore argued that Jet's "smart cart" system—which gives customers opportunities to save money when they buy multiple items at once or agree to a longer delivery time—would eventually entice a price-conscious swath of Middle America. "We weren't seeing the benefits of it because we had not yet reached scale," Lore says. "But the model was absolutely viable. I think the market is massive, and even a small share of a trillion-dollar [retail industry] is a pretty big business."

In early 2016, with Jet churning through its new cash, one of the startup's board members used that pitch on Wal-Mart, hoping to get Lore an introduction to McMillon. It worked, and Lore flew out for a meeting in Bentonville. What started out as a preliminary discussion about an investment in Jet flowered quickly into a corporate bromance. In June, McMillon visited Jet's offices in Hoboken, wearing a brand-appropriate purple shirt. Lore says they spent considerable time at a whiteboard, sketching out a shared future: "We just sort of immediately saw eye to eye on what needed to be done." It's unclear if harps played in the background.

They both needed the partnership: McMillon to send up a flare for employees and investors about the importance of Wal-Mart's online efforts, and Lore to pay off his backers and escape the fundraising circuit, where he'd spent about half his time over the previous two years. McMillon also came away with a handy pitch for Wal-Mart shareholders who might have blanched over the purchase price—that the company's founder himself would have loved Jet.com. "The Jet concept of sharing savings

*NOT COMPLETED

with customers is a very Sam Walton-like idea," says Richard Cook, co-manager of the Cook & Bynum Fund, which owns Wal-Mart stock. "You will help us lower costs, and we will share that savings with you."

McMillon and Lore structured the Jet deal differently from Amazon's purchase of Quidsi. Lore took over Wal-Mart's entire e-commerce business in the U.S. and combined the Jet and Walmart.com teams, though he continues to run them as separate websites.

In January, hoping to streamline the two companies' digital strategies, Lore eliminated 200 jobs in Silicon Valley and created a new class of so-called category specialists, each of whom oversees a narrow product area, such as food-storage bags or cribs, on both sites. He also changed these employees' incentive structure. Instead of evaluating them entirely on quarterly profit and loss, as Wal-Mart managers have been judged in the past, Lore introduced five bellwethers related to the customer experience, such as whether products are in stock, how easily they can be found on the site, and how quickly they're delivered.

Lore says he enjoys a kind of autonomy at Wal-Mart that he never had inside Amazon—about as close to a criticism of his former employer as he'll make. "When you give people all the information and you trust them and keep everything fair," he says, "people have room to run and to be empowered."

The Wal-Mart fulfillment center in Bethlehem, Pa., is a marvel of 21st century retail. It's an absurdly vast 1.2 million square feet, with products stacked 40 feet high on metal shelves that extend in both directions nearly as far as the eye can see. Quotes from Sam Walton—"To succeed, stay in front of change"—pepper the walls. The prevailing sensation in the warehouse is one of sound: The drone of conveyor belts and computer-controlled chutes threaded through the facility blends with a symphony of beeps from forklifts, producing an orchestral hum that drowns out the actual music playing on distant overhead loudspeakers. Flying along those belts at 8 mph is the bounty of modern capitalism: dog treats, underwear, Nintendo Switch controllers, Campbell's cream of chicken soup. "If Wal-Mart sells it, we fulfill it here," says David Tarnosky, the center's general manager.

Although the fulfillment complex and its five cohorts were built by Lore's predecessor, they're key to Wal-Mart's renewed bid for relevance. They allow the company to ship its most popular products anywhere in the country within two days on the ground or one by air, down from a week five years ago. These are table stakes in the pricey poker game that is contemporary e-commerce.

At one end of the facility, among rows of yellow-safety-vest-wearing packers earning about $14 an hour, another aspect of the strategy reveals itself. In February, in one of his first acts in his new role, Lore scrapped Wal-Mart's two-year-old Amazon Prime copycat, called ShippingPass, and instead offered free two-day shipping on any order of more than $35. (In a rare act of following a competitor, Amazon dropped its free-shipping minimum purchase from $49 to $35 for non-Prime members.) The free-shipping gambit has translated into boxes packed to the brim with jumbles of baby wipes, paper towels, and other everyday items. The sight should come as a relief to the company's accounting department. "Shipping one unit is *ex-pen-sive*," McMillon says, drawing out the word. "It costs five bucks to ship one item, seven bucks to ship seven. So when you aggregate volume on the supply side, the economics change in your favor."

He contends that you can't ship items individually and make money, but that may not be entirely true. Amazon, with its vaster scale and hyperefficient fulfillment centers, has trained consumers to order a single product whenever they need it. Wal-Mart may never get there, but it has other advantages, which Lore plans to exploit. The main one is the cost efficiency produced by its 4,700 stores, hundreds of distribution centers, and 6,200 trucks, which prowl the country bearing the company slogan, "Save Money. Live Better." Wal-Mart has spent decades ensuring it can ship products to its stores more cheaply than any other retailer, which also means it can do so more cheaply than sending them directly to customer's homes. Lore wants to entice shoppers to stores with discounts and then lure them inside to pick up jumbo packs of bottled water, bags of charcoal, and other products, where Wal-Mart's prices can't be beat. To do so he's experimenting with a 16-foot-tall octagonal orange "pickup tower" code-named Rapunzel—a vending machine that sits inside a store, holds as many as 300 orders, and spits the right one out when a customer feeds info into a touchscreen.

He's also prioritizing groceries. Wal-Mart, the country's leader in this category, allows grocery pickup from 600 locations and plans to add an additional 525 this year. "If Wal-Mart can translate that food trip to the digital realm, they're in a good spot," says Robin Sherk, an analyst at Kantar. "For them, winning online grocery is mission-critical."

Finally, Lore hopes to rip out the barriers between the store and the e-commerce business that have stymied Walmart.com in the past. For example, he's expanding a service called Easy Reorder: Everything you buy with a credit card at a Wal-Mart store will show up in your online account, ready to be replenished with one click. It'll almost certainly hurt store traffic in favor of online sales, but Lore says that shouldn't matter: "If you don't want to let another business cannibalize your customer, you have to let them shop whatever way they want to."

Of course, Wal-Mart's biggest challenge is that its primary rival isn't standing still. An estimated half of all U.S. households subscribe to Amazon Prime, according to a report from Consumer Intelligence Research Partners. And Amazon currently takes more than $5 out of every $10 spent buying stuff online, says Macquarie Research. Its market value, buoyed by its cloud-computing business, is now around twice Wal-Mart's. In Seattle, Amazon is also trying out concepts, such as the Amazon Go store, where customers are automatically charged for items they pick from shelves without going through a checkout line, and a hybrid supermarket-and-pickup center for people who order groceries online. All of this stands to eat into Wal-Mart's advantages.

There are other challenges. Can Wal-Mart translate its domestic progress overseas, particularly in the fast-moving markets of China and India, currently outside Lore's domain? And can Lore, a veteran of grow-at-all-cost startups, find long-term profits in Walmart.com to satisfy the company's vocal investors?

Lore doesn't seem overly anxious about that last issue. Over lunch, he shares a story about his teenage daughter, who's started an online sticker-selling business whose proceeds go to philanthropies fighting celiac disease, an autoimmune disorder. When his daughter recently told him she was making money, Lore says, he was shocked. "How are you profitable?" he asked her.

"Well, Dad, it's easy," she replied. "You just make sure your revenues are higher than your expenses."

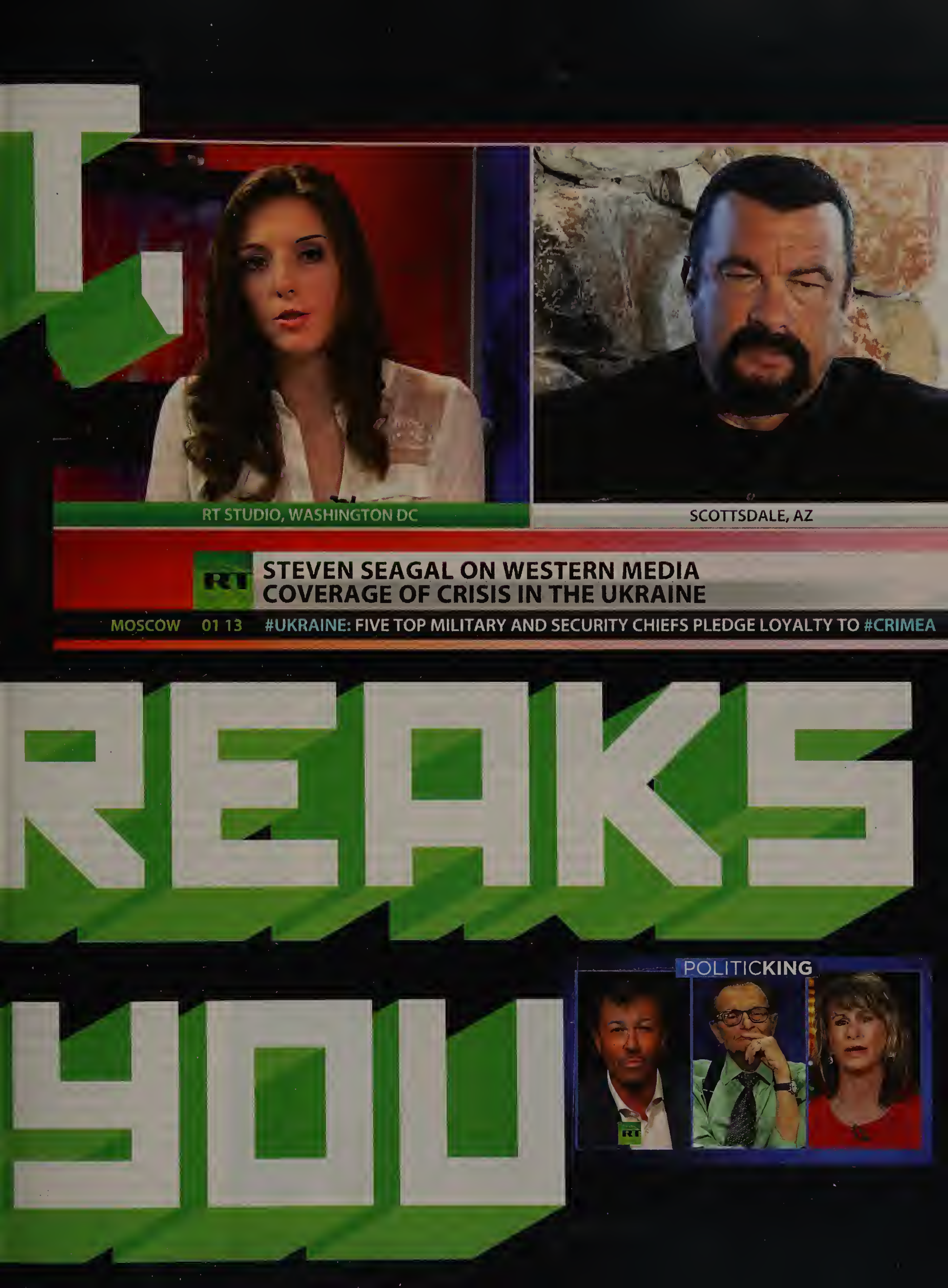
"Oh," Lore recalls saying. "I never really thought about it that way."

One wonders what Sam Walton would make of that. Ⓑ
—*With Molly Smith*

RT R
NEWS B

The U.S. intelligence community says the network once known as Russia Today helped Putin swing the U.S. election. How could such a low-wattage channel wield so much power?

By Simon van Zuylen-Wood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WHERE ELSE ON CABLE

About 17 million U.S. households subscribe to Spectrum, the television provider formerly known as Time Warner Cable. Those in New York City, whether they know it or not, also subscribe to the Russian-funded news outlet RT. Customers can locate it by scrolling past the Chinese Channel and the Africa Channel and into the triple digits, until RT's radioactive-green logo appears on screen.

Like any 24-hour cable news outlet, RT has good days and excruciatingly slow days. April 24, the day after the first round of France's presidential election, figured at least to be interesting. Russia was being accused of trying to tip the race in favor of the right-wing nationalist Marine Le Pen, and RT, if you believe the U.S. intelligence community, is at the vanguard of Russia's soft-power strategy. So around noon that Monday, sitting at home in Brooklyn, I flip to Spectrum channel 218.

The coverage is being anchored from a raft on the Seine by two impassive, middle-aged Brits. The broadcast is live, but the hosts mainly introduce prerecorded segments from RT's Paris bureau. Much of France has been exhaling at the election result, which saw the centrist Emmanuel Macron finish ahead of Le Pen. On RT, the mood is dour. One segment, set to menacing, *Jaws*-style strings, depicts violent outbursts from the previous night. There's fire and tear gas. A young man kicks ineffectually at a glass door. "They're not happy with anybody," a reporter intones.

Next up, a bit titled "France of Rich & France of Poor," which contrasts a workaday pro-Le Pen town with a snobby Paris suburb. "Enough of this boutique land," a correspondent says. In the early afternoon, Janice Atkinson, a British member of the European Parliament who tweets as @Janice4Brexit, arrives at the floating studio. After dissing Macron as a "very, very unknown 39-year-old boy who has basically married his mother"—his wife is 25 years his elder—Atkinson goes off-message, accusing Russia of "doing an awful lot of meddling, don't you think?" The anchors look at their feet.

At 4 p.m., RT hands off to RT America, its Washington, D.C.-based operation, which offers its regular mixture of anodyne headline news and niche opinion shows: *Watching the Hawks*, an occasionally paranoid show featuring the sons of Jesse Ventura and Oliver Stone; Larry King interviewing Mario Batali. When the feed returns to Paris at 8 p.m., a correspondent bats down talk of Russian electoral interference, above a chyron that reads, "Media overwhelmingly back Macron despite Le Pen only 2% away."

All in a day's coverage for RT, which began in 2005 as Russia Today, a Moscow-based, English-language competitor to Al Jazeera and BBC World News. But even as it added foreign bureaus and its staff increased to more than 2,000, its reach remained limited to a niche on the anti-Establishment Left. Journalists condescended to it. Politicians and cable operators shunned it.

During last year's U.S. election, as evidence mounted that Russia had orchestrated cyberhacks to boost Donald Trump's candidacy, RT and its aggressively anti-Hillary Clinton coverage became harder to ignore. The network also made news for a 10th anniversary dinner it hosted in Moscow in late 2015, at which former counterintelligence official and Trump campaign adviser Michael Flynn spoke for a $45,000 fee and sat at Vladimir Putin's table. In January the CIA, FBI, and NSA jointly released a declassified report alleging that RT had sought to undermine the "U.S.-led liberal democratic order." And in March, Jeanne Shaheen, a Democrat from New Hampshire, introduced a bill in the Senate to investigate whether RT America and the Russian government coordinated to "spread misinformation." ("They'll soon start shooting our journalists at the squares," RT Editor-in-Chief Margarita Simonyan responded.)

All this sounds serious—much more serious than any of the frankly terrible TV I watched. RT's coverage of U.S. politics, the war in Syria, and the cozy Trump-Russia relationship may well offer a window into the Kremlin's PR strategy, but if the network's largely young, left-wing journalists work on behalf of the Russian state, they hardly seem aware of it. Mostly they're getting into Twitter feuds with CNN's Jake Tapper and, they will quietly admit, looking for better jobs. If, as the authorities would have it, RT is executing a successful hearts-and-minds campaign to undermine the liberal democratic order, the liberal democratic order may be more vulnerable than we thought.

Michael Flynn

By the time Putin assumed Russia's presidency in 1999, the country had developed a relatively robust post-Soviet media. Gradually he wrested every major outlet from private control and blanketed the airwaves with Kremlin PR. With the country also enjoying an oil and gas boom, Putin became more popular than ever. Abroad, not so much.

Enter Russia Today, which was developed by former Russian press minister Mikhail Lesin as an urbane foreign counterpart to domestic telly. The network would imitate the look of Western cable news while disrupting narratives critical of Russia—or, as Putin later put it, while breaking "the Anglo-Saxon monopoly on the global information streams." Kremlin-funded, but in theory editorially independent, Russia Today was staffed by telegenic Brits and perfectly bilingual Muscovites. Its annual budget started at $30 million and increased 10-fold over the next five years. (By comparison, the BBC World Service's annual budget is about $450 million; the federally funded Voice of America somehow spends $220 million.)

Most cable channels receive fees from broadcasters for the right to air them, but it wasn't clear that Russia

Today would draw enough viewers to make the prospect attractive to the likes of Comcast Corp. and Time Warner Cable. So the network paid for access to the largest U.S. cable markets—the same strategy Rupert Murdoch followed when Fox News was in its infancy—and an impossible number of random hotels around the country. It soon became clear, though, that nobody outside Russia cared to watch coverage of its domestic affairs. So in 2009, Simonyan, a wunderkind Russian reporter, pivoted to global news. She created Spanish- and Arabic-language bureaus out of Moscow, plus standalone operations in London and Washington, and dropped "Russia" from the channel's name, rebranding it RT.

The shift created a new problem. During the Soviet era, Radio Moscow had pushed socialist ideology abroad, but none of the hallmarks of Putin's Russia—he-man nationalism, Orthodox Christianity, cronyism—were so easily exportable. "Russia doesn't have a coherent ideology to project," says Alexey Kovalev, a Moscow journalist and media critic who formerly worked for the state news agency, RIA Novosti. "The only thing we can do is bring others on our level, to tell everybody that Western values don't mean anything."

In 2009, McCann Erickson created a slogan for the channel: "Question More." Rather than foster a message of its own, RT would prick holes in everyone else's. The next year it launched an offshoot, RT America, on the second floor of a building three blocks from the White House.

RT's funding structure helped ensure that any political ties to Russia wouldn't be subject to special scrutiny from the American government. The network was incorporated in Russia as a nonprofit organization, TV-Novosti, which then transferred funds to a separate, U.S.-incorporated company, RTTV Inc. This structure allowed it to bypass the U.S. Foreign Agents Registration Act, which requires entities representing foreign political interests to disclose themselves as such. But it also contributed to a chaotic, ad hoc corporate environment. A Maryland-based Russian who owned RTTV early on pleaded guilty in 2013 to tax fraud after stashing more than $1 million of the company's money in a personal account. Control was transferred to its news director, Mikhail Solodovnikov, a former reporter for a Russian TV outlet.

NEWS COULD A 27-YEAR-OLD

A lot of RT America's early coverage was absurd and conspiratorial, promoted by YouTube headlines such as "Obama an alien president?" A former employee told me she was asked in her job interview how she would cover the annual Bilderburg Group conference in the Netherlands, long a shadowy boogeything to the antiglobalist set. But what RT America lacked in editorial rigor it made up for in opportunity.

An emblematic early hire was Abby Martin, a pox-on-everybody iconoclast who'd caught RT's attention for her freelance coverage of Occupy Wall Street. In 2012 she began hosting a nightly show, *Breaking the Set*. For her the appeal of RT America was editorial freedom; where else on cable news could a 27-year-old inveigh against U.S. imperialism on a nightly basis? "It was a huge space for radicals against the neoliberal Establishment," she says. "I wouldn't necessarily say this was my No. 1 choice, working for the Russian government to speak out against our policies. But in this abysmal media environment, it was really gratifying to be given this platform on an international stage."

Martin had a six-figure social media following and did nothing if not "question more." In 2013 she attacked MSNBC's Rachel Maddow for mocking "truthers" who maintained the Sept. 11 attacks were an inside job. "Is it really so hard to believe the fact that Bush and his cabinet turned a blind eye to let the attacks happen, or even ensure that they happened?" she asked. RT also sought out far-left critics of U.S. foreign policy, who would reliably argue that Western critiques of Russian belligerence were hypocritical. These people ranged from random New Black Panthers and Chomskyite beardos to WikiLeaks founder Julian Assange, who got a short-lived show. The *Financial Times* described the network's nonstop anti-U.S. coverage as "whataboutism"—as in sure, Russia has problems, but what about the States?

RT America's coverage of issues such as mass incarceration and domestic surveillance wouldn't have been out of place on Al Jazeera America or MSNBC. But the overarching aim of making the U.S. look unstable or undemocratic gave the productions a hyped-up, amateurish quality. Republicans and Democrats alike were portrayed as corporatist tools; during the 2012 election, RT America rallied behind Ron Paul.

It further marginalized itself with self-interested foreign coverage. In 2014, when Russia invaded Crimea, RT pushed the line that Ukraine was engaging in a "genocidal" massacre of civilians. Martin denounced Russian aggression on her show, and two days later one of her colleagues, Liz Wahl, resigned on air, saying she couldn't work for a network that "whitewashes the actions of Putin." But the incidents were more embarrassing to the network than threatening. (Martin left in 2015 and now hosts a show on a channel funded by the Venezuelan government.)

In 2016, RT America at last began proving its usefulness to the Russian government. The outlet remained as second-rate as ever, but during an election campaign governed by populist rage, anti-Establishment whataboutism had fresh appeal. RT America's editorial staff appeared enamored of Bernie Sanders; the Kremlin was tempted by Trump. The result was a fire hose of negative Clinton coverage, with almost nightly segments about her private email server.

As Election Day drew near, a synergy developed between RT's election coverage and Russia's apparent hacking efforts. In July the channel aired a segment promising fresh Clinton campaign email revelations. "Julian Assange claims next leak will lead to arrest of Clinton," read the chyron. The story was based on an interview Assange had given more than a month earlier in which he said he *didn't* believe his batch of emails would yield an indictment. The promised emails never came, but Trump benefited just the same.

Judging the reach of RT's election coverage is tricky. The TV station is watched by so few people that Nielsen doesn't bother to publish its ratings. (RT commissioned a study by market researcher Ipsos in 2016 that put total weekly U.S. viewership at 8 million, but it didn't release the methodology.) And while RT has more total YouTube views than CNN or BBC America, leaked documents have shown its stats to be heavily inflated by random disaster footage that the network buys the rights to broadcast. Still, RT managed to set the pro-Trump agenda in the danker corners of the internet—its

INVEIGH AGAINST U.S. IMPERI

pro-Bashar al-Assad or anti-George Soros articles were reposted everywhere from breitbart.com to InfoWars to the neo-Nazi forum stormfront.org. The Assange clip was viewed more than 700,000 times; weeks before the election, pro-Trump websites and alt-right trolls were still using it to whip up readers.

Toward the end of the race, professional journalists and self-styled muckrakers began to trace Russian electoral interference to RT. The January U.S. intelligence report went further, devoting most of its declassified findings to RT's critical coverage of U.S. affairs. A lot of people found such assertions laughable. In a blog post, the *New Yorker*'s Adrian Chen argued that one widely circulated independent study failed to distinguish between "explicit tools of the Russian state" and the "useful idiots" who did their bidding unwittingly. Masha Gessen, in a piece published on the *New York Review of Books*' website a few weeks before Trump's inauguration, mocked the government for casting RT America's coverage of fracking and Occupy Wall Street as un-American subversion. The declassified report, she wrote, "suggests that the U.S. intelligence agencies' Russia expertise is weak and throws into question their ability to process and present information."

As if to prove Gessen's point, the day after her piece was published, at a U.S. Senate Select Committee on Intelligence hearing covering "Russian Intelligence Activities," Senator Roy Blunt (R-Mo.) asked National Intelligence Director James Clapper, "Does RT get any of its broadcast into the United States?"

Clapper replied, "Yes it does, sir. It does, it's very prevalent in Europe and lesser so–" He paused. "I think there's an RT channel here."

Washington's bemusement was on display in February at the Beltway ritual known as the Conservative Political Action Conference. Ed Schultz, a 63-year-old populist who once hosted a nightly opinion show on MSNBC and now anchors a news program on RT America, was appearing there for a panel on trade. In his new incarnation as an anchor for a Russian media outlet accused of subverting democracy, he drew a sizable crowd.

"Full disclosure," he began. "The Russians did not tell Hillary Clinton, 'Don't go to Wisconsin.'" He then praised the new president, whom he'd once openly scorned, for appealing to disaffected workers: "For years they thought the Democrats and the progressive movement was their friend. But wait a minute, the jobs left anyways. So a guy named Donald Trump comes up, who's not bought and paid for by anybody, who pulls up in a 757 and says, 'I care about your jobs.' He ain't fakin' it. He's successful."

In a post-panel press scrum, a reporter suggested Schultz had become a mouthpiece for Putin. He replied, "The perception is that we're propaganda, and we simply are not." More journalists appeared. "I don't believe that Russia is the enemy of the United States," he said. "I think this is all big paranoia."

Eventually he extricated himself, and we walked together toward the exit. On our way out, he spied Fox News's Ed Henry standing alone outside a ballroom. Relieved to see a familiar face, Schultz loped over to greet Henry, saying, "The one. The only. There's only one Fast Eddie!" Henry looked up from his phone, grinned, and said, "Making Russia great again–I love it."

RT America collects discarded pundits. Schultz signed on after MSNBC canceled his nightly show in 2015. In 2013, Larry King, now 83, inked a deal to air his independently produced interview shows, *Larry King Now* and *Politicking*, on RT America. (He occasionally throws shade at the outlet to assert his editorial freedom.) Ex-Minnesota Governor and conspiracy buff Jesse Ventura has hosted a show and will return later this year with a second. Such hires may seem desperate, but they're in a sense on-brand for an operation that pits itself relentlessly against the mainstream media.

Schultz almost never grants interviews anymore, precisely to avoid unpleasant grillings about his new job, but as we rode back to his office in a company SUV, he told me a story. After the 2010 BP PLC oil spill in the Gulf of Mexico, he'd gone down to report for MSNBC on the environmental toll. "The PR people at BP were calling us every night," he said. "They just didn't want to accept the fact that we were telling the truth." The implication was that at RT, there are no ads or shareholders, and thus no corporate pressure to soft-pedal stories about oil spills. (Neither MSNBC nor BP would comment on Schultz's assertion.)

There was, however, Putin to please. I asked Schultz if he'd ever had editorial disagreements with RT. "No. Not once," he replied. Crimea? Syria? "No. Not in our shop."

I found that hard to believe. But his underlying critique is foundational to RT: the notion that CNN and Fox News, by virtue of their corporate owners and sponsors, reflect a U.S. perspective no less than state-funded RT reflects a Russian one. "There is not a single international foreign TV channel that is doing something other than promotion of the values of the country that it is broadcasting from," Editor-in-Chief Simonyan told a Russian newspaper in 2016.

To that end, RT America's 60-odd journalists are encouraged to see themselves as members of the alternative press. In morning editorial meetings, says one reporter, the easiest way to get a story greenlighted by Solodovnikov is to devise an angle that puts it in conflict with the "mainstream media." That might mean framing reports on Russian hacking as neoliberal scaremongering, or staking out a story cable news was slow to cover, such as the Dakota Access Pipeline protest. A former producer says that when she was hired, she received a list of websites from which to gain inspiration. The main theme was skepticism of U.S. power, with liberal standard-bearers such as the *Nation* juxtaposed alongside tinfoil-hat concern InfoWars.

The channel also self-selects for those suspicious of the mainstream press. Tyrel Ventura, co-host of the evening show *Watching the Hawks* and son of Jesse, says his dad was ostracized from politics, then cable news, for his heterodox beliefs. "I saw [MSNBC] essentially silence my father because he wouldn't cheerlead the Iraq War," says Ventura, 39. "Growing up, I already had that kind of skepticism of the quote-unquote official story of the media, learning about the JFK assassination and reading the *People's History of the United States*." He says he's never been given marching orders at RT to cover anything–instead, the impetus is to find stories that aren't "covered to death."

Ventura isn't spinning me. None of

the dozen or so former and current employees I spoke with said they'd been coerced into airing positive content about Russia or its allies. Instead they described a blanket self-censorship: Clearly, certain stories—say, a negative piece about Assad, a Putin client—aren't worth pitching. But in a more general sense, by casting all mainstream media reportage as corrupted—as fake news, in essence—RT claims the moral high ground for its own set of facts.

This dynamic is perhaps most evident in the work of RT's Middle East correspondent, a 31-year-old Brit named Lizzie Phelan. Unlike her colleagues in the Western media, Phelan has been granted a journalist visa by Syria. As a result, she is confined to reporting from government-held areas unlikely to reflect the most heinous crimes of the Syrian regime. But what some might see as pro-Assad propaganda winds up looking, to a certain kind of skeptic, like credible indie journalism. Phelan's work is popular on both the anti-imperialist Left and the alt-right.

Staffwide self-censorship is useful in another regard: RT America probably couldn't script propaganda if it wanted to. It isn't organized enough. The news director, Solodovnikov—everyone calls him Misha—is a former Washington bureau chief for the Russian broadcaster VGTRK. Everyone I spoke to described him as apolitical. Instead, says Abby Martin, "he's obsessed with aesthetics, lighting, the colors, the names." Beyond that, there's little quality control—Solodovnikov's whims govern all. During the 2016 Rio Olympics, according to several staffers, he urged reporters to cover golf and tennis results—two events nobody cared about, but which he followed assiduously. One reporter recalls a meeting a couple of years earlier during which Misha enthusiastically suggested hiring a "midget" to appear on air. Often, current and former employees say, he wouldn't show up to the office at all. Through a spokesperson, RT didn't respond to the assertion about Solodovnikov's hiring suggestion and described his comings and goings as "mundane."

"Do not call him an evil genius who is maniacally pulling the strings and making things happen," Martin says. "It's the contrary of that. There are weeks when he's just gone. I have friends at RT now who are just like, 'Misha hasn't been here all month, we have no idea where he is.' "

ISM ON A NIGHTLY BASIS?

At the outset of Trump's presidency, as the web of known connections between his campaign and Russia grew stickier, RT America tended to cast itself as a victim of mainstream media bullying. In January, Chris Hedges, a former *New York Times* foreign correspondent who hosts the weekend show *On Contact*, said the Russian interference story was being pushed by a "compliant corporate media that operates in a nonfact-based universe every bit as pernicious as that inhabited by Trump." A few days later, RT host Anya Parimpil mocked CNN on Twitter for covering a fireworks display at Trump's inauguration rather than something more substantial. Anchor Jake Tapper tweeted: "Next time tune in when we're discussing how your boss Vladimir Putin is responsible for human rights abuses and cyberattacks of US." Parimpil shot back, "Childish McCarthyism aside, your *actual* boss, Jeff Zucker, created Trump. Now let's watch careerists like you fall in line and punch left."

In general, RT America seemed unsure how to cover the new administration. It was hard-wired to view American power skeptically, but disinclined to go negative on the putatively isolationist, pro-Vlad Trump. Like Jon Stewart after Barack Obama's election, it seemed to have lost its raison d'être. It was the dog that caught the car. Would RT America, like Stewart, cast itself primarily as a critic of the president's critics, or could it offer something more substantial?

To try and get an answer, I sat down in March with the enigmatic Misha at a cafe near RT America's New York offices, on Manhattan's East Side. Our interview was much delayed; RT America's offices were under renovation, and he apparently didn't want me to see the place in disarray.

Solodovnikov, ginger-haired and bearded, was wearing red jeans and a blue blazer. That day, RT America had scored its first-ever daytime Emmy nomination, for *On Contact*. We began discussing RT's ambitions for his shop. His goal, he said, was to "make RT America the No. 1 international network in the U.S." I asked how he planned to do that. "You gotta have a good team, good journalists," he said, in accented English. "You gotta have critical thinking."

He didn't articulate the editorial vision his ideal team of journalists would present, and instead supplied critiques of his competitors. BBC and France 24 were irrelevant, he said, and CNN's talking-head approach was stale. "You watch certain networks and they almost behave like opposition parties, especially after elections," he continued. "And I feel like as a viewer you get a feeling that all your taste buds are messed up, because you don't get a taste for what's really news anymore."

It was hard to argue the point. And if the proliferation of biased and fraudulent journalism had poisoned the public's appreciation for objective reporting, well, RT was happy to take advantage. "It's never been easier for us to work in the United States," Solodovnikov said. "It's extremely easy to say the truth."

But what would that truth look like? A few weeks later, in early April, Assad was accused of launching a chemical attack on his own citizens; two days after that the U.S. responded with a missile attack on a Syrian air base, reportedly giving Russia only a cursory heads-up. Putin called the gas attack a "false flag," engineered to goad Trump into action.

RT followed suit. The day after Putin's statement, RT America reporter Alexey Yaroshevsky published an "exclusive" interview with an MIT professor who said he didn't believe Assad was responsible for the chemical attack. The Moscow-based show *Crosstalk*, a *Crossfire* imitator, ran an episode called "War-a-Lago." And a recent edition of liberal pundit Thom Hartmann's *The Big Picture* was teased online with the headline "Trump Risks World War for Tiny Syrian Intervention."

Suddenly, U.S.-Russia relations had returned to their familiar dismal state. For RT, that wasn't necessarily a bad thing. "They win either way with Trump," says Bob Orttung, an international relations professor at George Washington University who studies Russian media. "Even if he's not particularly pro-Russian, they can elide that fact and focus on all the chaos. That's their main point. To show that American society is descending into chaos."

Even for the most marginal of government-funded, internet-savvy cable-TV channels, that may not be a difficult task. ⓑ

PETER NAVARRO, TRADE WARRIOR

DONALD TRUMP'S FAVORITE ECONOMIST SAYS BUYING FROM CHINA STRENGTHENS A POTENTIAL ENEMY

BY PETER COY
ILLUSTRATIONS BY ZOHAR LAZAR

As he stepped onto the stage at the annual meeting of the National Association for Business Economics, Peter Navarro knew he was facing a tough crowd—or what passes for one in the staid world of the social sciences. It was March 6, Day 46 of Donald Trump's presidency, and Navarro, then the head of the newly created National Trade Council, was due to make a speech. His positions on trade have led many of his fellow economists to regard him as a traitor to their class. Navarro has a doctorate in economics from Harvard and has taught for more than 30 years at the University of California at Irvine's Paul Merage School of Business, but he's far more skeptical of free trade than many of his peers, for whom it's not just another issue but a foundational principle. "Truly disappointing," wrote Harvard economist Gregory Mankiw, who was President George W. Bush's chief economic adviser for two years, in September of a Trump campaign white paper that Navarro co-wrote. It was the economist equivalent of a body slam.

At the NABE event, roughly 500 business economists had gathered at the Capital Hilton, a few blocks from the White House, to hear Navarro talk. "Good morning," he began, an edge to his voice. The audience barely murmured. "It's not church. Come on—good morning," Navarro demanded. More murmurs. Giving up on that, he launched into his speech. The title, *Do Trade Deficits Matter?*, got right to the reason for the cool reception. Navarro argued that conventional economists think trade deficits don't matter—and that they're wrong. Trade is good, he said, but not when trading partners cheat.

Countries that use dollars from trade surpluses to buy up American assets, he said, are pursuing a strategy of "conquest by purchase." He added, "Most of those in our profession have chosen to ignore the broader national security risks that stem from large and persistent trade deficits and the concomitant decline of our manufacturing and defense industrial base." Suppose, he told the economists, the acquirer isn't an ally but "a rapidly militarizing strategic rival intent on hegemony in Asia and perhaps world hegemony." The implication: Not only were the people in the room costing Americans their jobs, they could even get them killed.

After the speech, a bow-tied moderator, studiously neutral, read questions that were handed up from the audience. One defended the Trans-Pacific Partnership, the 12-nation trade deal that Trump backed out of after taking office. Navarro, incredulous, asked for the piece of paper the question was written on. "I'm saving this for my memoirs," he said, condemning the TPP as "simply a bad deal" and a "death knell" for makers of autos and auto parts. "I'll cherish this card," he said. "Anyone want to own up to this one?" The room was sullen. It was a typically provocative performance from the man who appears to be Trump's favorite economist.

Navarro doesn't always get his way. He and the other nationalists on Trump's team, including chief strategist Steve Bannon, contend with defenders of the status quo such as Jared Kushner, the president's son-in-law, and Gary Cohn, the head of the National Economic Council. Which faction is winning can seem to vary by the news cycle. Trump, who before the election damned the North American Free Trade Agreement as "the worst trade deal maybe ever signed anywhere," is now talking about mending it, not ending it. The president has shrugged off his campaign promise to declare China a currency manipulator "on Day One." He even says he's now open to making trade deals with China in return for its help with North Korea.

Navarro, who's 67 and fit, with combed-back white hair, works out of a large corner office in the Eisenhower Executive Office Building, where his stand-up desk faces the White House. During an interview in his office, Navarro got one sentence into recounting his biography—"I was born in Cambridge, Massachusetts"—when a call from Commerce Secretary Wilbur Ross, the billionaire investor, came in on his cell. Ross is Navarro's main conduit to Trump. He went out in the hallway to talk and didn't come back for 20 minutes. When asked later about Navarro, Ross sent a restrained statement through a spokesperson. "Peter was a great help during the campaign." He added a sentence about the administration's intention to fix bad trade deals that made no mention of Navarro. When I told Navarro a few weeks later that Ross's statement seemed lukewarm, he got Ross to send me a new one. This one said that since the campaign "we have continued to work closely together on Executive Orders and other projects." Ross wrote that they often debated the details, but added, "This is a strong point of our relationship and a process that results in well-vetted conclusions."

Navarro has been on a high recently. He's spearheading the president's nationalistic "Buy American, Hire American" initiative, which tightens enforcement of federal procurement rules and cracks down on alleged abuse of H-1B visas and other foreign-hiring programs. On April 29, Trump called Navarro "one of the greats at trying to protect our jobs" and named him director of a new, permanent Office of Trade and Manufacturing Policy, which replaces the National Trade Council. Trump's condemnation during his campaign of various trade deals as "terrible" and "a rape of our country" seemed sincere, and he badly needs a win as president. If he's stymied on health care and taxes, he could bang the drums on trade even harder. That would be good for his adviser. Navarro "could be down this week and back next week," says William Reinsch, former president of the pro-trade National Foreign Trade Council. "As an adviser or counselor or whisperer in Trump's ear, I suspect he won't go away."

Navarro would be intriguing even if he'd never joined the Trump administration, simply because he presents such a challenge to his profession's mainstream. Since World War II, presidents and lawmakers of both parties have tended to heed the textbooks: Free trade encourages companies and workers to specialize, lowers prices, and keeps U.S. producers sharp; displaced factory workers should be able to find new jobs; if they fail, they can be compensated for their losses with a small share of society's gains. In 2012, 95 percent of leading economists surveyed by the University of Chicago Booth School of Business agreed with the following statement: "Freer trade improves productive efficiency and offers consumers better choices, and in the long run these gains are much larger than any effects on employment."

Voters never fully bought into that message, though, and they're getting less deferential to authority figures. In 2013, according to a paper by economists at Booth and Northwestern University, 76 percent of the general public said "buy American" requirements have a positive effect on U.S. manufacturing employment. Only 11 percent of economists agreed.

Navarro is as skeptical of trade as the average blue-collar American, if not more. His 2011 book, *Death by China: Confronting the Dragon—A Global Call to Action* (written with Greg Autry), argues that the U.S. and China are on a trajectory for armed

conflict. Trump blurbed a 2012 documentary film based on the book, narrated by Martin Sheen, as "Right on.... I urge you to see it." The trailer features a knife, representing China, that's plunged into a red, white, and blue map of the U.S. Blood leaks from the tricolor corpse.

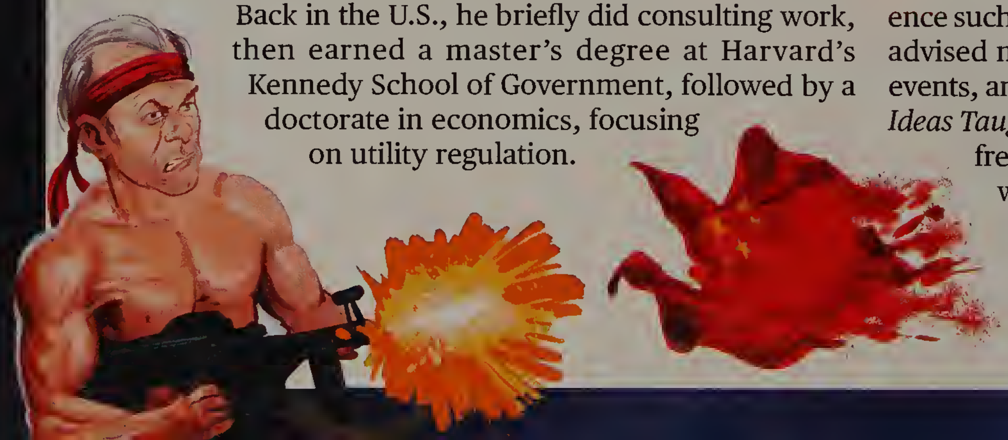
A lot of Democrats don't know what to make of the Trump-Navarro trade agenda. They may be turned off by the bluster, pugnacity, and flag-waving, but many share the sense that free trade has served multinational corporations better than ordinary Americans. Vermont Independent Senator Bernie Sanders said in January that he'd be willing to work with Trump on "a trade policy which works for the American worker." In March the liberal Roosevelt Institute credited "right-wing economic authoritarianism" with co-opting aspects of the trade policy playbook of progressives, leaving them "struggling with whether to pivot right, left, or center on trade questions." Robert Hockett, a Cornell Law School professor who was a spokesman for Sanders's presidential campaign, says he finds a lot about Navarro to admire. "Mr. Navarro's position on trade liberalization," he wrote in an email, "can be viewed as representative of that of MANY Democrats and Republicans who initially bought into the promise that free trade would 'lift all boats,' only to be quite reasonably disillusioned."

When Navarro was a child, his father, Al, played saxophone and clarinet and led a house band that did the hotel circuit—summers in New Hampshire and winters in Florida. "We lived out of a station wagon" part of each year, Navarro says. His parents divorced when he was 9 or 10, and his mother got a job as a secretary for a Saks Fifth Avenue in Palm Beach, Fla., raising him and his older brother on her small weekly paycheck. When the family moved to Bethesda, Md., a teenage Navarro worked as a stock boy and security guard, delivered the *Washington Post*, and pumped gas. He slept on a couch in the living room of the one-bedroom apartment. "That kind of upbringing makes you stronger," he says. "You learn to survive on your own. I was a latchkey kid. By high school, I pretty much was cooking a lot of my meals."

On Navarro's first day at Bethesda-Chevy Chase High School, a guidance counselor "took one listen to my Southern accent and wanted to vocational-track me," he says. "That's the first I remember standing up for myself. I told him in no uncertain terms I would pursue an academic track." He finished near the top of his class. Although only 5-foot-6 at the time, he played guard on the varsity basketball team, and he went to Tufts University with a full academic scholarship.

Navarro leaned left in his youth. In the early 1970s, he spent three years in the Peace Corps in Thailand, where he resurrected an old British language-teaching lab, borrowed a bulldozer from an air base to dig tilapia ponds, and played rhythm guitar in a 16-piece orchestra. ("My father had not passed on his musical talent to me," he confesses.)

Back in the U.S., he briefly did consulting work, then earned a master's degree at Harvard's Kennedy School of Government, followed by a doctorate in economics, focusing on utility regulation.



"I found my calling," he says. He wrote a 1981 *New York Times* op-ed with one of Harvard's most famous economics professors, Dale Jorgenson, that criticized a Reagan administration tax proposal as "a very large corporate subsidy." He supported free trade in a 1984 book, *The Policy Game: How Special Interests and Ideologues Are Stealing America*, arguing that tariffs "protected the profits of a small core of domestic industries" while harming consumers. (He explains that because "the globalist erosion of the American economy" was just getting started, he hadn't recognized it then.)

After earning his Ph.D. in 1986, Navarro moved to the northern edge of San Diego and in 1989 got a job up the coast teaching at UC Irvine's business school. He reminisces about swimming two or three times a week in La Jolla Cove, surrounded by dolphins, and windsurfing on Mission Bay. He was troubled by what he saw as uncontrolled Los Angeles-style development beginning to destroy the idyllic area, spawning traffic, jamming students into prefab buildings, and spewing raw sewage into the ocean. He founded a group called PLAN—Prevent Los Angelization Now—which marked his entry into politics.

"Blond, brash, and charismatic" is how the *Los Angeles Times* described him in those days. Navarro ran for mayor of San Diego on the Democratic ticket in 1992, losing with 48 percent of the vote. He later lost elections for the county board of supervisors, city council, and the U.S. House of Representatives, selling himself as a Democrat who could win over Republican voters. One poster for his 1996 congressional race read, "Peter Navarro. The Democrat Newt Gingrich fears most!"

As the force behind PLAN, he infuriated developers by fighting their projects while saying he supported growth. "How is it that someone who has been so contradictory can get away with those contradictions and not be dismissed as an inconsequential leader?" asked Robert Lichter, a shopping center developer who was informally designated by his peers to do battle with Navarro at the time.

Reached by phone in March, Lichter says he was stunned that a man who'd campaigned to restrain development was working for President Trump, the world's most famous property developer. "When he came into town, nobody knew who he was," Lichter says. "Somehow he ended up making a name for himself. He had a winning smile. He had the Redford white teeth.... He was really not a friend of business, which is interesting when you consider today," says Lichter, who calls himself an avid Trump supporter. "When we opened the paper and first saw his name as an adviser to Trump's campaign, I went, 'Oh, my God, Peter, how did you pull this one off?' I would never in a million years have imagined it. It is the antithesis of the Peter Navarro I knew."

Aside from a leave of absence during the mayoral race, Navarro kept teaching at UC Irvine during his campaigns, which ended with his fourth loss in 2001. In the 2000s he began churning out investing and management titles for a general audience such as *If It's Raining in Brazil, Buy Starbucks* (2004), which advised mom and pop investors to trade on macroeconomic events, and *What the Best MBAs Know: How to Apply the Greatest Ideas Taught in the Best Business Schools* (2005). His distaste for free trade had begun to emerge as early as 1993, when he wrote a book praising President Clinton's agenda—except for Nafta, which he took to calling Shafta. Navarro says his concerns grew in the mid-2000s, when he noticed that some of his evening students were being displaced from their day jobs in management. "At the time, I didn't know what the cause was," he says,

"so I started asking questions, and all roads seemed to lead to Beijing."

He concluded that China's competitive advantage wasn't just from lower wages, which would be a fair fight, but from unfair trading practices such as illegal export subsidies, currency manipulation, and theft of intellectual property. He wrote *The Coming China Wars: Where They Will Be Fought, How They Will Be Won* in 2006 and then *Death by China*, the book that caught Trump's attention, in 2011. Navarro made another intellectual leap in 2015 when he ventured from trade economics into military strategy with *Crouching Tiger: What China's Militarism Means for the World*. He warned that neoisolationism toward China was tempting but dangerous: "If this head-in-the-sand trend continues, this is a story that can only end badly for all of us."

Navarro, director of the brand-new Office of Trade and Manufacturing Policy, receives Trump's signing pen near Harrisburg, Pa., on April 29

Navarro's critics point out that despite his Ph.D. from Harvard, he has no scholarly credentials in the field of trade. He did team up with one widely published scholar—Glenn Hubbard, the dean of Columbia Business School and former chief economic adviser to President George W. Bush—for a 2010 book called *Seeds of Destruction: Why the Path to Economic Ruin Runs Through Washington, and How to Reclaim American Prosperity*, which was billed as a bipartisan blueprint for reform. When asked after Navarro's NABE speech about that collaboration, Hubbard said, "You won't find much of the rhetoric you heard this morning in the book."

Navarro says he's well-versed in classic trade theory, dating to David Ricardo in the early 1800s, because he teaches it: Countries, like people, should produce what they're best at and import the rest, yadda yadda yadda. "I know how it works, but more importantly I know how the Ricardian trade model doesn't work," he said in an August interview with Bloomberg.

He blames Nafta and China's 2001 entry into the World Trade Organization for much, if not all, of a 15-year economic slowdown in the U.S. The country grew an average 1.8 percent a year during that span, down from 3.4 percent from 1986 through 2000. Other economists cite a wider range of causes for the deterioration, from a productivity slowdown at home to cheap-but-legal competition from the developing world. Not Navarro. "Bad trade deals are at the heart of America's economic malaise," he says. "Trump knows that in order for the global economy to prosper, we need to trade freely. But he's not going to stand, for a second, cheating."

Last August, Trump named Navarro to a 13-member economic policy advisory team along with powerful finance types such as hedge fund billionaire John Paulson. In December the president announced the National Trade Council and said Navarro would be the first person to head it. Navarro was given one employee, Alexander Gray, who specializes in the defense industrial base and shares the office at the Eisenhower building. They haven't bothered to decorate, other than a couple of maps and a moody Ogden Pleissner painting from 1940 of an auto plant converted to a ship factory. Attached to the White House-facing wall are three poster-size sheets on which Navarro has scrawled to-do lists in red marker. On the floor next to the door are two pairs of running shoes, which he wears for running to work and then home again.

Rare speeches aside, most of what Navarro does involves planning Buy American, Hire American; assisting Ross and others in prepping for bilateral trade negotiations; and helping companies, workers, farmers, and ranchers injured by unfair foreign competition. Right now that includes Whirlpool Corp.'s fight with South Korea's LG Electronics Inc. and Samsung Electronics Co., which he accuses of "country-hopping"—changing manufacturing locations to avoid penalties for dumping products into the U.S. at below cost. (Samsung says it respects U.S. trade rules. LG didn't respond to a request for comment.) The cases are referred to him by the Department of Commerce. "The best problems that come in for our SWAT team to solve are specific problems of an entity that can be generalized to a macro solution," Navarro says. As for White House infighting, nationalists vs. globalists is "a false narrative and a false dichotomy," he says. "It doesn't capture the sophistication and nuance of the way the team works together."

To be fair to mainstream economists, Navarro's portrayal of them as clueless theoreticians is a straw man. Many would agree that running chronic trade deficits can permanently undermine a country's production capacity while leaving it beholden to foreign creditors. Where they part with Navarro is over what to do about it. He and Trump convey more willingness to risk trade wars. They favor bilateral negotiations, in which they presume the U.S. has more bargaining power. But they're wrong to think that other countries will fold under strong U.S. pressure, says Reinsch, the pro-free-trader who's now a distinguished fellow at the Stimson Center, a Washington think tank. "In a lot of countries, standing up to the Americans is good domestic politics, whether it makes economic sense or not." By retreating from multilateralism, the U.S. could play into China's hands, some free traders argue. The vacuum left by the TPP could soon be filled by the Regional Comprehensive Economic Partnership, behind which China is the driving force.

There are still free traders who would like to dismiss Navarro as a Don Quixote tilting at Chinese-made wind turbines. That would be a mistake. He's saying what a lot of people are thinking—including, it would seem, the president. He's also on the same side as some of the most influential figures in the creation of America. Abraham Lincoln was an ardent protectionist. Alexander Hamilton, the first Treasury secretary, favored tariffs and subsidies to build a strong domestic manufacturing base. Scott Paul, the president of the Alliance for American Manufacturing, an industry group, says Navarro is squarely in that tradition: "Peter," he says, "is a Galileo or a Copernicus."

In an email, Navarro shared several lessons from politics: "Pick battles big enough to matter and small enough to win." "Get back up every time you get knocked down." And, sounding Trump-like, "You have a lot more 'friends' when you win than when you lose."

"My mission in life has been to look at big problems that matter," Navarro says. "I don't like labels, and I don't like to put myself in any category other than a pragmatist." Ⓑ

—*With Michelle Jamrisko and Andrew Mayeda*

Pitchfork Grows Up

By Devin Leonard

Ryan Schreiber's once-scrappy hipster-ironic music review site has made it to media's mainstage—and that means teaming with *Teen Vogue*

Photographs by Laurel Golio

Saby's All Right, a club in Brooklyn's Williamsburg neighborhood, is almost full when Ryan Schreiber arrives. A burly 41-year-old, he's wearing a dark overcoat open to display a vintage Whitney Houston T-shirt. Schreiber, founder of the groundbreaking music website Pitchfork, gets a beer and threads his way through the crowd for a better view of Melina Duterte, a 23-year-old singer-songwriter who plays under the name Jay Som; her debut album, *Everybody Works*, recently earned a glowing 8.6 (out of 10) review from Schreiber's site. He wants to hear how she sounds live, as he puts it, "before it becomes a job" for her.

Duterte is the kind of independent artist whom Schreiber set out to champion in 1996, when he started Pitchfork while living with his parents in Victoria, Minn. Along the way, he established what became the dominant voice of internet music reviewing. "It wasn't the detached, scholarly take of a *Rolling Stone* review," says Alan Light, a former editor of *Spin* and *Vibe*. "It stood out for its insidery, hipster tone."

Much has changed since 1996. Today, Schreiber employs 51 people, runs music festivals in Chicago and Paris, and has Fortune 500 advertisers. In 2015, Condé Nast, publisher of the *New Yorker*, *Vanity Fair*, and *Vogue*, bought Pitchfork for an undisclosed sum, and now Schreiber works in a comfortable office at Condé's headquarters in One World Trade Center in lower Manhattan.

The sale stunned the music world—Pitchfork warrants a 4.7 as a luxury brand in the Condé mold—yet it's easy to see why Schreiber liked the deal. Pitchfork was one of the first sites to get how the internet could mold listening habits, but now it's surrounded by digital rivals offering much more than snarky reviews. Streaming sites such as Spotify bypass the music press, using algorithms to recommend tunes, and social media has turned anyone with a following into a tastemaker. "Kylie Jenner can blow up a song by posting it on Snapchat," says Naomi Zeichner, former editor-in-chief of the *Fader*.

Schreiber says the sale wasn't a defensive move. The music geek who made it big has grand ambitions for Pitchfork. He wants it to be *the* clearinghouse for music reviews, videos, and news. To do that, he says, he needed a partner.

"Guys, Pitchfork is in the same business that we are"

A few days before the Jay Som show, Schreiber sits in his office talking about Pitchfork's origin story. He's been listening to *More Life*, the new Drake album, which the rapper dropped with little warning a day or two earlier. It's one of the things artists do these days that makes Pitchfork's job tougher. "We're all trying to work out our opinions," Schreiber says. (Contributing editor Jayson Greene's review gives it a 7.8.)

Schreiber barely graduated from high school in 1994 and didn't go to college. He got a job at a record store and watched as his music-loving friends published DIY zines that were long on enthusiasm, short on polish, and expensive to distribute. Schreiber thought, Why not publish one online?

In 1996 he started a monthly webzine called *Turntable* but rechristened it *Pitchfork Media* (to evoke the Midwest and a sharp edge) after another site claimed rights to the original name. Pitchfork's distinctive review system down to the decimal let writers elevate or disembowel records with surgical precision. One day, Schreiber got a call from an online record store, Insound, that wanted to advertise. He asked for $500. "They were like, 'Sounds great!' " he recalls. With that, Pitchfork became a business.

Still, Schreiber struggled to pay the rent. In 1999 he moved to Chicago, where he could see more shows. The next year he got a break when Radiohead released the otherworldly *Kid A* and Pitchfork contributor Brent DiCrescenzo penned an ecstatic but less-than-comprehensible 10 review that included lines such as "The butterscotch lamps along the walls of the tight city square bled upward into the cobalt sky, which seemed as strikingly artificial and perfect as a wizard's cap." Like much of the site's writing, the piece was mocked for its obtuseness. But what it lacked in clarity it made up for in timeliness and clickability: It was one of the first *Kid A* reviews posted online, and Radiohead fans spread it across the internet, accelerating Pitchfork's traffic and, in turn, its influence.

For a while, Schreiber kept doing double duty as editor-in-chief and ad salesman. In 2004 he made a plea on the site for a full-time advertising sales rep. Forty people applied; the last application he read was from Chris Kaskie, who had sold space for the *Onion*. Schreiber was ready to hire him over the phone, but Kaskie said they needed to have a beer first.

With Kaskie, who is now Pitchfork's president, selling ads, annual revenue hit about $5 million within several years. Schreiber hired a managing editor, and when locals raised

the idea of curating a music festival with him and Kaskie, the two figured it was good branding. After a trial run in 2005, the company took over the event the next summer, calling it the Pitchfork Music Festival. "Suddenly, people are like, 'Why are there 20,000 people going to see bands I've never heard of?' " Kaskie says.

By 2007, Schreiber had moved to New York, where there were even more concerts to see. He and Kaskie introduced Pitchfork.tv with web shows such as *Don't Look Down*, which featured live performances on rooftops. As Pitchfork delved into video, it attracted big-name sponsors like American Express Co. and Apple Inc. The reviews on the site became as erudite as those of the music magazines that Pitchfork had all but eclipsed in influence. The American Society of Magazine Editors nominated Pitchfork for a National Magazine Award for general excellence in digital media in 2013. It won.

Over the years, Schreiber brushed off would-be investors. But by 2014, Pitchfork needed money. The Brooklyn office was a cool place where employees could push desks against walls for bands to perform, but the toilets were unreliable. "Everything was on a shoestring budget," Schreiber says. At the same time, the site was working to broaden its coverage, not just in terms of platforms but to take a less parochial position on pop music. This made sense at a time when younger listeners—and writers—were as interested in Taylor Swift as Vampire Weekend.

More than anything, Schreiber wanted Pitchfork to keep growing. So he was open when Condé approached the same year. At first, Fred Santarpia, Condé's head of digital, wanted to see whether Pitchfork would share videos on a Condé site called the Scene, which features digital shorts, series, and documentaries. He thought Pitchfork content would make it easier to sell beer and soda ads. In the course of these conversations, Santarpia asked if Schreiber would sell the site. Schreiber said he would. It wasn't just that he'd read the *New Yorker* and *Wired* for years. He says he was impressed that the names atop the mastheads had editorial independence.

Inside Condé, the proposal needed explaining. Some of Santarpia's peers thought Pitchfork was a streaming site. Santarpia says he told them the site chronicled music the same way the company's magazines did fashion, politics, and food. "Guys, Pitchfork is in the same business that we are," he recalls saying. One supporter: *New Yorker* editor David Remnick. "I was thrilled with the idea," he said in an email.

When the acquisition was announced in October 2015, there was consternation in the media. "Condé Nast Purchase of Pitchfork Media Sounds Death Knell for Indie Rock," the *New York Observer* lamented. But indie rock hasn't died. It's just taken on new forms. Pitchfork contributed to an upcoming music issue of *Teen Vogue*, helping it prepare a timeline about music's role in social movements. Pitchfork editors also appeared in a holiday video with a peer at *Bon Appétit* to play Christmas records and mix Old-Fashioneds.

The sale has bolstered Pitchfork's appeal to advertisers. In January the company rolled out October, a site featuring beer news and reviews that's owned by brewing giant AB InBev SA/NV and ZX Ventures, its venture capital fund. Mike Raspatello, formerly a ZX director and now October's president, says he pitched the idea to Pitchfork last year. "Beer doesn't have its *Bon Appétit*," he says. Early on, the new site bit the hand that feeds it with a piece impaling the marketing of Budweiser, AB InBev's flagship brand, after Donald Trump's election. Raspatello says he didn't flinch: "The independence of the editorial is the most crucial aspect of the partnership." 61

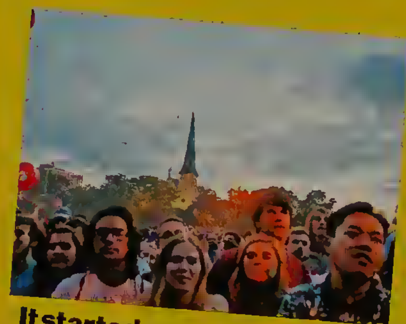
It might be a good time for Pitchfork to diversify. John Stein, a senior editor at Spotify AB who focuses on independent music for the service, says that although Pitchfork can still increase an artist's streams, "it's definitely different than it was maybe 10 years ago, where a good review or a bad review from Pitchfork could really, really change things."

Schreiber scoffs at this, noting that people are reading Pitchfork's reviews more than ever. According to ComScore Inc., the site had 2.7 million visitors in October 2015; a year later, it had 4.1 million. He's vigorously pursuing his strategy to make Pitchfork the No. 1 repository for music content: It's reviewing records that predate its existence to "fill in the gaps of our archive," he says. Pitchfork is also creating videos about records it considers epochal and celebrating anniversaries of classics such as Radiohead's *OK Computer*, which was released in 1997. "We wound up doing seven features and three videos," says Mark Richardson, Pitchfork's executive editor. It's also making playlists for Spotify's main competitor, Apple Music.

Anyone who argues that Pitchfork's influence is dimming should talk to Melina Duterte. Since breaking out, she's been hailed by NPR, the *New York Times*, and the *New Yorker*. But when Duterte meets fans, she knows who discovered her: "People say, 'I found you on Pitchfork.'" Ⓑ

How Pitchfork has expanded its business beyond snarky music reviews:

It collaborated on a special issue with *Teen Vogue*



It started a music festival in Chicago

It teamed up with *Bon Appétit*

It expanded the festival to Paris

In January, it introduced a beer website

GIVE ME A BREAK

Katrina Onstad's The Weekend Effect *is a manifesto for the overworked masses*
By Bret Begun

At the beginning of Katrina Onstad's *The Weekend Effect: The Life-Changing Benefits of Taking Time Off and Challenging the Cult of Overwork*, the author's 12-year-old son asks on a Sunday night, "Was that the weekend?" "Yes, it was," she replies. "But," he says, "it didn't *feel* like a weekend." Onstad, gripped with the anxiety any mom would have if her child were unaware that he'd just lived through two days off, does an audit of her family's last 48 hours. What she finds is a mix of work email, homework help, laundry, hockey practice, dog wrangling, grocery shopping, and more. The postmortem concludes: "To keep Sunday distinguishable from Saturday, I might top off the above with some light toilet cleaning."

The Weekend Effect (HarperOne, $25.99) is Onstad's chronicle of trying to rescue herself, her husband, and their two kids from the tyranny of overscheduling. It will read as familiar to many working parents, minus perhaps all the references to hockey (the author lives in Toronto). A journalist, Onstad takes a reportorial approach to solving the Mystery of the Disappearing Weekend, plunging herself into–and extricating herself from–various activities to provide a front-line account of how she tried, mostly successfully, to use her freedom more wisely. She attends an "ecstatic dance" party at 8:30 a.m. on a Sunday, gift-wraps Christmas presents for low-income families, joins a running club, and doesn't eat brunch, which she spends four-plus pages denouncing as "digestively as well as acoustically abrasive."

When Onstad isn't personally fleeing the cult of overwork, she's reporting on others who've escaped. These are people who have "hobbies," which is apparently something one can find time for. Her in-laws are bird-watchers. Her friend Dale is a ceramicist. Another friend, Liz, enjoys cooking, as long as it's not a production. Pro tip: If you make a boring pot of chili, guests will think it's exciting if you also serve cherry margaritas.

Finding the hours–and the will–to engage in our passions isn't a new challenge. After World War I, British philosopher Bertrand Russell lamented the loss of these pursuits, writing: "The pleasures of urban populations have become mainly passive: seeing cinemas, watching football matches, listening to the radio, and so on. This results from the fact that their active energies are fully taken up with work; if they had more leisure, they would again enjoy pleasures in which they took an active part." Change "cinemas" to "Netflix," Onstad points out, and Russell could have written this last week.

TWO DAYS AREN'T ENOUGH TO MAKE UP FOR A LIFE UNLIVED THE OTHER FIVE

Not only are we not playing amateur ornithologist or throwing pots, we're also using the weekend as a makeup session for a life unlived Monday to Friday. Which is why the Sunday night anxiety we have about returning to our jobs isn't only about impending deadlines but guilt about unfulfilled expectations. Onstad's advice: Do less, but make the activities count. Try to lock into what Hungarian psychologist Mihaly Csikszentmihalyi calls the "flow" state, an immersion in an activity deep enough to conjure a feeling of being "out of self, and out of time," as Onstad summarizes it. Have sex. Explore nature. "Of course, 'nature = good' is hardly an 'Extra! Extra!' revelation," she acknowledges.

Ultimately, that's the biggest problem with *The Weekend Effect*. There aren't enough "Extra! Extra!" revelations or solutions. I know walking dogs at the no-kill shelter, as I've been planning to do for two years, is a more substantive use of my time than watching college football. But I watch because it's fun! Also, when else but on Sunday am I going to do grocery shopping? Still, books such as this are valuable because they force readers to think about the agency they're exerting over their free time, and that alone can lead to deriving more of the pleasures Russell wanted us to experience. I thought a lot about this as I was reading *The Weekend Effect* on a recent Saturday and Sunday, having stupidly assigned myself a review for the section of the magazine I edit. At dinner with my parents on Sunday night, I considered asking my mom, "Was that the weekend?" Ⓑ

BLACK IS THE NEW BLACK

Put the "fun" in "funereal"

By Kurt Soller

When you think of buying a summer suit, the color black doesn't immediately come to mind. "Black used to be reserved for funerals, formal evening wear, or perhaps a board meeting," says Dan Rookwood, the U.S. editor of shopping site Mr Porter, where black tailoring from brands such as Ami and Boglioli is throwing the darkest of fabrics into a new light.

The idea popped up last summer, when Club Monaco made a handsome all-black seersucker suit, but it's grown from there. The fabrics and details of the new options tend to be even more experimental: Theory is making a black summer suit with stretchy elastane called the New Suit for its nascent "technical" line; Stampd, a streetwear brand, sells a blazer with an angular notched lapel. Many makers choose linen, merino wool, or a summer-weight blend, materials that lend themselves to unstructured jackets, looser pants, and the overall casual silhouette that's back in style—think '80s Armani, but less billowy. Usually, the jackets are unlined, which makes them lighter weight—and comfortable—in hot weather.

Saturdays Surf NYC, a label as chill as its name, makes its double-breasted black blazer and matching pleated pants in a linen-cotton blend that feels island-ready even on the sweatiest city day. "Because of the rise of streetwear, guys are wearing more black," says Morgan Collett, the brand's co-founder. He sells his suit as separates for men who like to mix it up, splitting the jacket and pants into different looks, say, or throwing on both with a pair of white sneakers and a band T-shirt. When I wore Boglioli's unlined hopsack blazer to my office, it went well with a pair of black jeans, Vans slip-ons, and a white oxford. No one asked whose funeral I was attending, but colleagues did want to know where I was headed after work; apparently, the outfit screamed "dinner reservation." That's no bad thing. As Rookwood puts it: "It's worked very well as a uniform for Tom Ford for years."

Boglioli slim-fit unstructured wool-hopsack blazer
$1,095; mrporter.com
3x1 jeans
$285; 3x1.us
Orley shirt
$295; orley.us
AM Club scarf
$220; amclub.co
Want Les Essentiels briefcase
$1,295; wantlesessentiels.com
John Lobb loafers
$1,175; johnlobb.com

A band collar shirt is ideal for summer.

Pair dark tailoring with a shirt that's light-colored—or a graphic tee if you're in a rakish mood.

Wear black jeans—or light blue ones—on days when you're not feeling a full suit.

Italian men have been mixing black and blue for decades. Your turn!

GETTING THE G

Golden Door spa, once the "it" retreat for Ho

Then: The original gym; men's volleyball in the pool; a Turkish bath; Jim Backus, *Gilligan's Island*'s Thurston Howell III, in a weight-loss machine; Szekely in front of the golden door

It was the place for Hollywood to recede, refresh, and renew. Or more accurately, to drop out, dry out, and lose those stubborn last 10 pounds before the next project. Burt Lancaster, Bob Cummings, and Johnny Weissmuller went on hikes here; Marilyn Monroe, Elizabeth Taylor, Natalie Wood, Kim Novak, Barbra Streisand, and a thousand lesser lights hid out here. Aldous Huxley loved the mud wrap.

The place was the Golden Door, a 300-acre oasis in the desert hills of San Marcos, Calif., less than an hour north of San Diego. In 1959, Deborah Szekely and her husband, Edmund, a famous philologist and linguist, opened a mountain-lodge-meets-Japanese-tea-garden spa here, promising restoration and sanctuary. "In those early days, Golden Door was known as a fat farm," says Susie Ellis, a former staff member and now chief executive officer of the Global Wellness Institute in Miami. "Every woman was given pink warmup suits called pinkies, with matching pink turbans. And they all had avocado oil in their hair. It was quite a scene."

Golden Door remained a scene, weathering competition from spas such as Canyon Ranch and the Peninsula and drawing visitors like Nicole Kidman, Oprah Winfrey, and Arianna Huffington. However, some tarnish started to appear in 1998 after Deborah Szekely sold the spa to a hotel chain, which in 2005 sold it to an investment group—each owner in turn cutting staff and amenities to help the bottom line. Oddly, this downward spiral began right as the U.S. spa movement started booming, cutting further into profits. Resort hotels amped up offerings to lure tourists, and the day spa, once considered a strip-mall afterthought, manifested in upscale incarnations, giving women who couldn't afford to drink guava juice for a week in the desert a taste of the wellness life.

Golden Door's savior was an apostle: Joanne Conway, the wife of Carlyle Group LP co-founder and co-CEO Bill Conway Jr., who purchased the property and its 40 guest rooms for $24.8 million in 2012. Since then,

Now: A Watsu massage; the spa's chef prepares dinner from vegetables harvested that morning; a facial in progress; orange groves line the property's entrance; the on-site farm; Van Ness

MOURPUSSES BACK

A-listers, tries to reclaim its lost glory. By Michael Callahan

Conway, who'd visited 22 times, has been on a mission to return the spa to its rightful place. And she's succeeding, albeit with a different clientele. "Our demographic was people who were here to lose weight," says Kathy Van Ness, Golden Door's chief operating officer and the former CEO of Diane von Furstenberg Studio LP. "Now we get people who are as fit as you could possibly be, and they're exhausted. Their stress levels are so high."

To better cater to these exhausted, stressed-out people, Van Ness doubled down on the idea of Golden Door as a luxury respite and diversified its revenue streams, investing in a line of high-end organic beauty products and a farm stand. "It needed a complete overhaul," she says. "It wasn't in need of a brand—it was a brand that needed to come back to life."

Van Ness spent $15 million, doubling the spa's grounds, opening a boutique, and expanding its farm: The majority of the food that ends up on spa-goers' plates is cultivated on-site. There are 45 varieties of vegetables (Golden Door just put in 10,000 tomato plants), honey from beehives, and eggs from a chicken coop. Van Ness says that by 2027, farming could account for 5 percent of total revenue. Of course, there's also a pool, a salon, and access to daily massages, as well as a bamboo garden, 20 miles of hiking trails, and intangibles such as lush groves of orange, pear, and lemon trees; century-old oaks; and a weathered bell that gongs nightly, beckoning kimono-wearing guests inside for dinner.

Occupancy, which was 55 percent in the first quarter of 2013, hit 71 percent in the first quarter of this year. A new generation of A-listers—Amy Schumer, Rooney Mara, Lauren Conrad, Olivia Wilde—has discovered the place, and to attract more of them, the spa included gift certificates for free weeklong stays (price tag: $8,850 each) in the gift bags of this year's top Oscar nominees. Conway, meanwhile, donates all the profits to children's charities. "My decision to buy the Golden Door was never about personal financial gain," she says. "It was about preserving a special place." B

TOP: IMAGES COURTESY GOLDEN DOOR; BOTTOM: PHOTOGRAPHS BY CHUCK GRANT FOR BLOOMBERG BUSINESSWEEK

CRAZY FOR CAULIFLOWER

A vegetable becomes a social media sensation
By Claire Suddath

For the past four years, chef Jason Weiner has offered a Meatless Monday menu at his restaurant, Almond, in New York. The idea, he says, is to urge omnivores to accept vegetables as a main course. To do this, he relies frequently on a versatile veggie almost everyone likes: cauliflower. "Cauliflower is this blank slate. It has the ability to take on any flavor, kind of like chicken," Weiner says. Over the years, Almond's Meatless Monday menu has included chicken-fried cauliflower, General Tso's cauliflower, and Buffalo cauliflower topped with Roquefort dressing, which was so popular that it was promoted to the regular menu.

Weiner isn't the only chef experimenting with the pale crucifer. "It's absolutely everywhere," says Elena North-Kelly, managing editor at the James Beard Foundation, a culinary arts organization. "Cauliflower's moved from the boring side dish, and now we're seeing it take on a starring role." Girl & the Goat in Chicago tops it with pickled peppers. Ox in Portland, Ore., covers it in tahini sauce. At the Florence in Savannah, Ga., a cauliflower head is "whole-roasted" and served in a cast-iron skillet.

"IT'S ABSOLUTELY EVERYWHERE"

The vegetable's ascendancy may be why one of the first changes B&G Foods Inc. made after it bought the brand Green Giant from General Mills Inc. in 2015 was to expand its cauliflower line to include mashed cauliflower, a frozen cauliflower-and-sweet-potato medley, and cauliflower "rice." Whole Foods Market Inc., which has seen double-digit growth in nationwide sales of the vegetable two years in a row, offers similar products from its 365 brand. Both companies say they're seeing sales climb evenly across the country, rather than clustered around more foodie metropolitan areas, as has been the case with past trends.

The boom is thanks to converging culinary trends: low-carb, gluten-free, and healthful eating, which often means vegetarian. "It's similar to what we saw with kale a few years ago," says Erik Brown, global produce buyer for Whole Foods. And the vegetable's popularity is reflected on *BuzzFeed*'s Tasty channel, which posts dozens of DIY options—cauliflower mac and cheese, pizza with cauliflower crust, etc.—to Facebook feeds, where they've been viewed hundreds of thousands of times each.

Health food crazes in the U.S. aren't always practical: Acai berries are grown in South America, and good luck to any Northerner looking for a ripe avocado to top her toast in winter. But cauliflower grows everywhere, from New York to Michigan to California, with staggered growing seasons, so it's almost always available. It's also cheap. And most people already know it, if only as a conduit for ranch dressing on crudité platters.

For cauliflower converts, there are two types of recipes: ones that use the vegetable as is, and ones in which it replaces meat or bread. Cauliflower-as-staple-substitute recipes range in authenticity, from that Buffalo cauliflower (definitely not a chicken wing, but still spicy and delicious) to cauliflower grilled cheese, in which grated cauliflower "bread" patties supposedly hold the sandwich together but in reality crumble to pieces (at least for me).

In April, during a seasonal revamp of Almond's dinner menu, Weiner decided to discontinue the Buffalo cauliflower. To his surprise, customers complained. A few threatened to stop eating at the restaurant. One regular he knows left a scathing comment card urging him to "rectify this disaster." "I got the message," Weiner says. A week later, the Buffalo cauliflower was back. Ⓑ

Amy Jain

34, co-founder and chief executive officer, BaubleBar, New York

What do you do at BaubleBar? We sell trendy accessories to millennial women. We've been around for six years.

I like your bag. I call it my school bag—I carry it daily. I wear either pink or blue almost always, so it works with everything I put on.

How did the idea come about? Daniella [Yacobovsky], my co-founder, and I came up with it when we were shopping for shoes at Saks, and we realized that neither of us had ever been to the jewelry department. We were willing to spend money on shoes but not jewelry, and that made us pause. We talked to a lot of women, and they wanted a go-to brand for on-trend items at accessible price points.

Is that a BaubleBar bracelet? It's the Ion cuff, one of our best-sellers. It's adjustable. I have small wrists, so it's hard to find things that fit me.

How often do you wear dresses? I live in dresses. I'm from Dallas and used to wear dresses year-round, so it kills me that I have to wear tights half the year in New York.

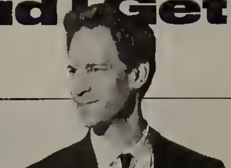
What's the story with your watch? My parents gave it to me when I got into business school. My mom knew I had my eye on it.

Did you add the belt to this one? The belt is part of the dress. It helps make it a little more casual.

Tell me about your shoes. They're so comfortable. They're the perfect amount of fashion for every day.

Interview by Jason Chen

How Did I Get Here?



DAVID KORINS

Founder and principal, David Korins Design

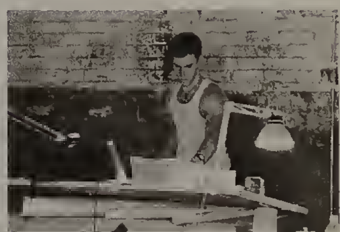
Education

Mansfield High School, Mansfield, Mass., class of 1994

University of Massachusetts at Amherst, class of 1999

"I had good attendance, but I didn't study. I won a write-in vote for senior class president."

1985



Drafting in the studio at the Williamstown festival, 2001

"It was the place I learned to build, paint, prop, and design."

Work Experience

1997–2011
Intern, design assistant, director of design program, resident designer, guest designer, Williamstown Theatre Festival

2001–07
Co-founder, Edge Theater Co., New York

2003
Production designer, *Winter Passing*

2004–Present
Founder and principal, David Korins Design. Clients have included McDonald's, Target, Google, and Kanye West (2011 tour and Coachella performance)

2006
Set designer, *Passing Strange*

2015–Present
Set designer, *Hamilton*

2016
Production designer, Fox's *Grease: Live!*

"We supported new writers who we wanted to see produced. Kurt Vonnegut came and took us out to dinner. Edward Albee came. To be a producer at 25 years old and have these titans of the theater come and support your work was incredible."

"It was my first Broadway musical. I probably meet someone once a week who tells me it was their favorite show of all time."

"I had never designed a film. It was a huge vote of confidence on behalf of the studio, Focus Features, to hire me."

FOCUS FEATURES

"We design theater, film, television, galleries, restaurants, hotels, interiors, rock concerts. Corporations come to us to do branded experiences."

DAVID KORINS DESIGN

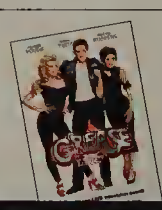
Presenting the *Hamilton* set model for the Public Theater production to the cast, 2014

"I found it incredibly stimulating working with Kanye. He's a real artist. It was also exhausting, because he wanted to make a new design for every city. We built different sets almost weekly."

"It was one of the hardest jobs I've ever done. That said, it was the most blissful experience, because I was in the trenches with my friends, doing a thing that we all believed in so much. It turns out, the whole world believes in it, too."

Earned a 2017 Tony nomination for best scenic design of a musical

"This year I'll have four musicals on Broadway at once, and they could not be more unalike: *Hamilton*, *Dear Evan Hansen*, *War Paint*, and *Bandstand*. The most satisfying thing is they're all shows I took on because of interesting collaborations and unique stories."



Accepting an Emmy for *Grease: Live!*'s production design, 2016

Life Lessons

1. "Don't have a phone-it-in mode. Go hard or go home." **2.** "The work expands to the amount of time allotted." **3.** "There are no economies of scale on any project."

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